SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924

No. 733

BLAKELY D. McCAUGHN, COLLECTOR OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES H. LUDINGTON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

1 In United States District Court for the Eastern District of Pennsylvania, December term, 1922. No. 9924

Charles H. Ludington v. Blakely D. McCaughn, collector of internal revenue

Docket entries

Jan. 31, 1923. Præcipe to issue summons filed.
" " " Summons exit—returnable first Monday in Feb., 1923.
" " " Statement of claim filed.
" " " Notice to file affidavit of defense filed.
Feby. 3, " Summons returned on January 31, served and filed.
" 5, " Appearance of George W. Coles for defendant filed.
Mar. 29, " Affidavit of defense raising questions of law filed.
April 30, " Præcipe to place case on argument list filed.
May 24, " Argued sur demurrer.
Jan. 14, " Opinion, McKeehan, J., granting leave to enter judgment for defendant filed.
Sept. 26, " Præcipe to enter judgment filed.
Sept. 26, 1923. Judgment in favor of defendant filed.
2 Sept. 27, 1923. Plaintiffs exception filed.
Sept. 27, 1923. Order of court allowing exception filed.
Sept. 27, 1923. Assignment of error filed.
" 27, " Petition for writ of error filed.
" 27, " Order of court granting prayer of petition filed.
Oct. 3, " Certificate of probable cause filed.
" 3, " Bond for costs sur writ of error filed.
" 3, " Order of court approving bond for costs filed.
" 3, " Copy of notice of appeal filed.
" 4, " Writ of error allowed and copy thereof lodged in clerks' office for adverse party.
" 4, " Citation allowed and issued.
" " " Præcipe as to transcript of record sur writ of error filed.
" 8, " Citation returned, service accepted and filed.

In United States District Court

Writ of error

UNITED STATES OF AMERICA, *ss:*

The President of the United States to the honorable the judges of the District Court of the United States for the Eastern District of Pennsylvania, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said district court, before you,

or some of you, between Charles H. Ludington and Blakely
3 D. McCaughn, collector of internal revenue, a manifest error hath happened, to the great damage of the said Charles H. Ludington, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Third Circuit, together with this writ, so that you have the same at the city of Philadelphia, within thirty days, in the said United States Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the fourth day of October, in the year of our Lord one thousand nine hundred and twenty-three.

[SEAL.]

GEORGE BRODBECK,
Clerk of the United States District Court,
Eastern District of Pennsylvania.

Allowed by
McKEEHAN, *J.*

4 In United States District Court

[Title omitted.]

Statement of claim, filed January 31, 1923

Plaintiff claims to recover from the defendant the sum of three thousand ninety-four dollars ($3,094) with interest from November 16, 1922, upon a cause of action as follows:

1. Plaintiff is a citizen of the State of Pennsylvania and a resident of the eastern district thereof.

2. Defendant is and was at the time of the occurrence of the matters herein complained of collector of internal revenue for the first district of Pennsylvania.

3. Under date of November 6, 1922, plaintiff received from the defendant notice of and demand for payment of additional income taxes for the year 1919, in the amount of three thousand ninety-four dollars ($3,094).

4. On November 14, 1922, plaintiff wrote to the defendant as follows:

"I am in receipt of your notice and demand, dated 6th in-
5 stant, advising me that there has been assessed against me $3,094, additional tax per office audit of my return for 1919 by the commissioner, and that to avoid penalty and interest this tax

must be paid to you not later than 16th instant. I contend that such tax is illegal and, if compelled to pay same, purpose bringing suit for repayment thereof to me. Please advise me as to the purport of the above notice and demand. Am I correct in understanding that it means that, if I do not pay the tax indicated, $3,094, by the 16th instant, you will proceed to collect same with the penalty and interest referred to in your notice, with costs, and that such collection will involve seizure and sale of my property?"

5. On November 15, 1922, in reply to the above letter, defendant wrote to plaintiff, as follows:

"Referring to your letter of the 14th inst., you are advised that if payment is not made in accordance with the terms stated on notice and demand forwarded to you this office will proceed to collect the amount due plus penalty and interest, as stated in your letter."

6. Thereupon, on November 16, 1922, plaintiff paid to the defendant, under protest and duress and in order to avoid collection of the same with penalties and interest by seizure and sale of plaintiff's property, the said sum of three thousand ninety-four dollars ($3,094).

7. On November 16, 1922, plaintiff filed with the defendant a claim for refund of said additional tax, alleging that the same had been illegally and erroneously assessed for the reasons hereinafter stated.

8. Under date of January 13, 1923, plaintiff was advised by the Commissioner of Internal Revenue that the said claim for refund had been rejected.

6 9. The said additional tax was due to the disallowance in part of a deduction claimed by plaintiff in his return of income for the year 1919 for losses sustained in the sale of certain investments, namely, four hundred ninety (490) shares United Gas and Electric Corporation, first preferred stock, and sixty (60) shares American Cities Company six per cent cumulative preferred stock.

10. The said four hundred ninety (490) shares United Gas and Electric Corporation preferred stock were acquired by plaintiff prior to March 1, 1913, at a cost of twenty-eight thousand dollars ($28,000). On March 1, 1913, the fair market value of said shares was thirty-two thousand four hundred forty-five dollars ($32,445). Plaintiff sold the same in 1919, and received therefor three thousand six hundred ninety-three and 81/100 dollars ($3,693.81), and in his return for income claimed as a deduction the loss on said sale amounting to twenty-eight thousand seven hundred fifty-one and 19/100 dollars ($28,751.19).

11. The said sixty (60) shares American Cities Company cumulative preferred stock were acquired by plaintiff prior to March 1, 1913, at a cost of four thousand five hundred dollars ($4,500). On March 1, 1913, the fair market value of said shares was four thousand six hundred five dollars ($4,605). Plaintiff sold the same in

1919, and received therefor one hundred seventy-three and 10/100 dollars ($173.10) and in his return for income claimed as a deduction the loss on said sale amounting to four thousand four hundred thirty-one and 90/100 dollars ($4,431.90).

12. In computing the income tax for 1919, the Commissioner of Internal Revenue used as the basis for determining the
7 amount of loss upon the said sales the cost of said securities instead of the fair market value thereof on March 1, 1913, resulting in a reduction in the amount allowed as a deduction on account of said transactions, and consequent increase of taxable income in the amount of four thousand five hundred fifty dollars ($4,550), resulting in an additional tax of three thousand ninety-four dollars ($3,094) as aforesaid.

13. Plaintiff is advised, and therefore avers, that under the provisions of section 202 of the revenue act of 1918, the basis for the determination of loss sustained from the sale or other disposition of property, real or personal, if such property was acquired prior to March 1, 1913, is the fair market price or value of such property as of March 1, 1913.

14. Plaintiff is advised, and therefore avers, that under the law he was entitled to claim as a deduction for income tax purposes the loss sustained upon the sale of said securities represented by the difference between the fair market value thereof as of March 1, 1913, and the amount received therefor.

15. Plaintiff is advised, and therefore avers, that article 1561 of regulations 45, which reads:

"Where the fair market value as at March 1, 1913, is greater than the cost and the sale price is less than the cost, the deductible loss is the amount by which the cost exceeds the selling price."

is unreasonable and in contradictionof the express provisions of the revenue act of 1918.

Wherefore plaintiff claims that the said additional tax in the amount of three thousand ninety-four dollars ($3,094) has
8 been erroneously and illegally assessed and claims to recover the same from the defendant with interest from November 16, 1922.

Ralph B. Evans,
Attorney for Plaintiff.

[Jurat showing the foregoing was duly sworn to by Chas. H. Ludington omitted in printing.]

In United States District Court

Affidavit of defense, filed March 27, 1923

Blakely D. McCaughn, collector of internal revenue for the first collection district of Pennsylvania, files this affidavit of defense raising questions of law as follows:

1. The statement of claim filed does not set forth facts sufficient to constitute a cause of action.

2. Article 1561 of regulation 45 promulgated under revenue
9 act of 1918 as set forth in paragraph 15 of the statement of claim is not as alleged, unreasonable and in contradiction of the express provisions of the revenue act of 1918, but is reasonable and lawful.

Wherefore the defendant prays the judgment of the court upon the questions of law herein raised and if these are sustained that judgment may be entered for the defendant. If, however, the questions of law are decided adversely to the defendant, the defendant prays leave to file an affidavit of defense to the averments of fact contained in the statement of claim.

B. D. McCaughn,
Collector of Internal Revenue.

[Jurat showing the foregoing was duly sworn to by Blakely D. McCaughn omitted in printing.]

10 In United States District Court

Opinion sur affidavit of defense raising questions of law, filed June 14, 1923

McKeehan, J.

The plaintiff sues to recover $3,094, the amount of an additional income tax assessed against him for the calendar year 1919 and paid under protest. Prior to March 1, 1913, he purchased certain securities for $32,500 and sold them in 1919 for $3,866.91. Thus the difference between the cost and the selling price, the actual loss, was $28,633.09. The selling price, however, was $33,183.09 less than the market price of the securities on March 1, 1913. In his income tax return, the plaintiff claimed the larger sum as a deduction and the commissioner reduced the amount of the deduction to the actual loss, thereby increasing the plaintiff's tax by $3,094.

The plaintiff stands upon the letter of section 202 of the revenue act of 1918 (approved February 24, 1919, 40 Stat. 1060–1067), and insists that if it means what it says, he is entitled to the deduction he claimed. This section provides:

"Sec. 202 (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be . . .

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; . . ."

This provision standing alone, gives color to the plaintiff's contention, but not when considered in relation to the sixteenth amendment and in relation to other provisions of the act. The grant
11 of power extended only to the taxation of actual income. The act intended to tax only actual income, which means actual gross income less the deductions specified in the act. Included in

gross income are "gains, profits and income derived from . . . sales or dealings in property, whether real or personal." And among the deductions allowed are "losses sustained during the calendar year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit, though not connected with the trade or business."

The adoption of the sixteenth amendment was proclaimed by the Secretary of State on February 23, 1913, and in order that gains and losses that had accrued prior to that time should be excluded in the computation of "income," the market price as of March 1, 1913, was selected as the basis for computing gains and losses as to property acquired prior thereto. In other words, the act was to operate only on gains and losses accruing subsequent to the adoption of the amendment. But in selecting this method of accomplishing the result, Congress did not intend to impose a tax on a mere fictitious or paper profit, or to permit the deduction of a mere fictitious or paper loss. Only actual gains are taxed; only actual losses are deductible. The intent and purpose of section 202 is this: That where a part but not all of an actual gain accrues after March 1, 1912, only so much as accrues after that date is income, and where a part but not all of an actual loss accrues after March 1, 1913, only so much as accrues after that date is deductible. It is a limitation upon the amount of gains that are taxed and of losses that are deductible. Given an actual gain or loss, the market value on March 1, 1913, was
12 selected as a reasonable criterion for determining how much, if any, of the gain or loss accrued subsequent to the adoption of the amendment.

In Walsh v. Brewster, 255 U. S. 536, one of the transactions before the court involved securities that Walsh purchased in 1902 and 1903 for $231,300 and sold in 1916 for $276,150, an actual gain of $44,850. Their market value on March 1, 1913, however, was only $164,480 and the collector assessed the tax upon $111,670, being the difference between that market value and the selling price. The decision was that the assessement was illegal and that Walsh was taxable only on his actual gain of $44,850. Another transaction involved in the Walsh case was the purchase of securities in 1899 for $191,000 and their sale in 1916 for the same amount. Their market value on March 1, 1913, however, was only $151,854. The decision was that a tax assessed on the difference between that amount and the selling price was illegal, no actual gain having been realized. In Goodrich v. Edwards, 255 U. S. 527, one of the transactions had reference to securities that had been purchased in 1912 for $500 and sold in 1916 for $13,931.22. The market value on March 1, 1913, was $695. Thus there was an actual gain of $13,431.22, but only $13,236.22 of it had accrued subsequent to March 1, 1913. The decision was that the tax was properly assessed on the latter amount. The other transaction involved in the Goodrich case was a block of securities purchased in 1912 for $291,600 and sold in 1916 for $269,346, an actual loss of

$22,254. The market value on March 1, 1912, however, was only $148,635, so that the taxpayer had a paper profit of $120,711, on the basis of the March 1, 1913, value. The decision was that an actual loss having been sustained, a tax assessed upon the paper profit was illegal. Whether the taxpayer could have claimed a deduction for his actual loss of $22,254 was not before the court and was not decided.

13 The questions decided in these cases had to do with gains, not losses, and the cases arose under the income tax law of 1916. But the provisions of that act on this question differed only in arrangement and not in substance with the act of 1918. Section 2 (c) of the act of 1916 provided that "for the purpose of ascertaining the gain derived from the sale" of property acquired prior to March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such gain derived," and section 5, in dealing with allowable deductions, provided that "for the purpose of ascertaining the loss sustained from the sale" of property acquired before March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such loss sustained." Thus, under the act of 1916, losses were to be computed in the same way as gains, and these provisions were substantially reenacted in section 202 of the act of 1918. So I think that the Supreme Court's construction of the act of 1916 as to the computation of "gains," applies equally to the computation of "losses" under the act of 1918.

The plaintiff, therefore, was not entitled to a deduction in excess of his actual loss, and the additional tax of $3,094 was properly assessed. Judgment may be entered for the defendant.

In United States District Court

Præcipe for judgment, filed September 26, 1923

To the clerk of the court:

In accordance with the opinion of the court filed June 14, 1923, enter judgment for the defendant.

RALPH B. EVANS,
Attorney for Plaintiff.

14 In United States District Court

Judgment, filed September 26, 1923

Before McKEEHAN, J.

And now, September 26, 1923, in accordance with the opinion of the court, and by præcipe filed, judgment in the above-entitled cause is hereby entered in favor of defendant and against the plaintiff.

By the court.

Attest:

E. G. JOHNSON,
Deputy Clerk.

In United States District Court

Exception, filed September 27, 1923

And now, to wit, on the twenty-seventh day of September, 1923, the plaintiff, Charles H. Ludington, by his attorney, Ralph B. Evans, prays the court that he be allowed an exception to the following order of the court, filed June 14, 1923:

(1) "Judgment may be entered for the defendant."

RALPH B. EVANS,
Attorney for Plaintiff.

In United States District Court

Order allowing exception

PHILADELPHIA, *September —, 1923.*

Before the Hon. ———

And now, to wit, on the twenty-seventh day of September, 1923, it is ordered that the exception be allowed as prayed for.

MCKEEHAN, *J.*

15

In United States District Court

Petition for writ of error, filed September 27, 1923

The above-named plaintiff, Charles H. Ludington, conceiving himself aggrieved by the judgment entered on September 26, 1923, in the above-entitled proceeding, doth hereby appeal from said judgment to the United States Circuit Court of Appeals for the Third Circuit, and he prays that this his appeal may be allowed and that a writ of error issue; and that a transcript of the record and proceedings and papers upon which said judgment was made, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Third Circuit.

RALPH B. EVANS,
Attorney for Plaintiff and Appellant,
Charles H. Ludington,
1335 Land Title Building, Philadelphia, Pa.

In United States District Court

Order allowing writ of error, filed September 27, 1923

PHILADELPHIA, *September 27, 1923.*

Before MCKEEHAN, J.

And now, to wit, on the twenty-seventh day of September, 1923, it is ordered that the appeal be allowed as prayed for.

By the court.

Attest:

GEORGE BRODBECK, *Clerk.*

16 In United States District Court

Assignment of error, filed September 27, 1923

And now comes Charles H. Ludington, plaintiff, and makes and files this his assignment of error.

(1) The District Court of the United States for the Eastern District of Pennsylvania erred in sustaining the affidavit of defense raising questions of law and ordering that judgment may be entered for the defendant.

RALPH B. EVANS,
Attorney for the Plaintiff, Charles H. Ludington,
1335 Land Title Building, Philadelphia, Pa.

In United States District Court

Præcipe for transcript of record, filed October 4, 1923

To the clerk of the court:

Prepare transcript of the record of the above-entitled cause for filing in appeal to the Circuit Court of Appeals.

In making up the transcript the following should be included:

Docket entries.
Writ of error.
Statement of claim.
Affidavit of defense.
Opinion.
Judgment.
Petition for writ of error.
Order allowing writ of error.
Assignment of error.
Clerk's certificate.

RALPH B. EVANS.

17 In United States District Court

Clerk's certificate

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, sct:

I, George Brodbeck, clerk of the District Court of the United States for the Eastern District of Pennsylvania, do hereby certify that the annexed and foregoing is a true and faithful copy of so much of the pleas and proceedings in the case of Charles H. Ludington v. Blakely D. McCaughn, collector of internal revenue, No. 9924, December term, 1922, as per præcipe filed, a copy of which is hereto attached, the transcript of record in the above-entitled cause is to include, now remaining among the records of the said court in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said District Court at Philadelphia, this thirtieth day of October, in the year of our Lord one thousand nine hundred and twenty-three, and in the one hundred and forty-eighth year of the Independence of the United States.

[SEAL.] GEORGE BRODBECK, *Clerk.*

18 In United States Circuit Court of Appeals for the Third Circuit

No. 3087. March term, 1924

CHARLES H. LUDINGTON, PLAINTIFF IN ERROR

vs.

BLAKELY D. McCAUGHAN, DEFENDANT IN ERROR

Order assigning judge, filed March 11, 1924

In error to the District Court of the United States for the Eastern District of Pennsylvania.

And now, to wit, this 11th day of March, A. D. 1924, it is ordered that Hon. Frederick P. Schoonmaker, district judge for the Western District of Pennsylvania, be, and he is hereby assigned to sit in above case in order to make a full court.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]

19 In United States Circuit Court of Appeals

[Title omitted.]

Argument and submission

And afterwards, to wit, on the 11th day of March, 1924, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the honorable Victor B. Woolley and honorable J. Warren Davis, circuit judges, and honorable F. P. Schoonmaker, district judge, and the court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 1st day of October, 1924, come the parties aforesaid by their counsel aforesaid, and the court, now being fully advised in the premises, renders the following decision:

20 In United States Circuit Court of Appeals

[Title omitted.]

Opinion filed October 1, 1924

In error to the District Court of the United States for the Eastern District of Pennsylvania.

Before Woolley and Davis, circuit judges, and Schoonmaker, district judge.

WOOLLEY, circuit judge:

This case calls for an interpretation of sections 214 (a) and 202 (a) of the revenue act of 1918 (40 Stat. 1060–1067) allowing deductions in an income tax return for losses sustained and prescribing the method by which they shall be ascertained. The facts, briefly stated, are these:

Prior to March 1, 1913, Charles H. Ludington purchased shares of stock of two corporations for $32,500. In 1919 he sold them for $3,866.91, thereby sustaining a loss of $28,633.09. In making his income tax return for the year in which the sale occurred and conceiving that he was entitled to a deduction for the loss involved, he turned to the law for guidance. This was the revenue act of 1918, now superseded by other acts. He found (by sections 210 and 211) that upon his "net income" there should be levied, collected, and paid for the taxable year a normal tax and a surtax at named rates. From section 212 (a) he learned that "the term 'net income' means the gross income as defined by section 213, less the deductions allowed by Section 214."

Section 214 (a) provided that:

"In computing net income there shall be allowed as deductions: * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * * ."

From this it was clear that the statute allowed Ludington to deduct his loss in computing taxable net income. It was equally clear that the statute did not allow him to calculate his loss in any way he chose, not even in the ordinary way of subtracting selling price from cost price, but prescribed a method of its own. This appeared in section 202 (a) and was as follows:

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof."

21 Reading this provision literally, Ludington inquired the fair market value of his shares on March 1, 1913, and learned

that the shares of both stocks had risen from their purchase price and, together, had on that date a market value of $37,050. He now had all the factors for any kind of calculation. What he did was to follow the words of the statute. He took $37,050, the market value of the shares on March 1, 1913, as the "basis" of his computation, and from this figure subtracted $3,866.91, the selling price in 1919, leaving a balance of $33,183.09. This was his loss ascertained by the formula prescribed by the statute which, as it happened, was $4,550 larger than his actual loss. He deducted the statutory loss and filed his return accordingly.

The Commissioner of Internal Revenue, however, declined to recognize the fair market value of the shares on March 1, 1913, as the basis for ascertaining the loss sustained and, reducing the estimated loss by the sum of $4,550, he brought it down to actual loss and assessed upon the net income, thus increased, an additional tax of $3,094. The commissioner grounded this action upon an amendment to article 1561 of Regulations 45, adopted July 28, 1921, which, in computing loss, substituted cost in place of the statutory basis of market value as of March 1, 1913, where the market value as of that date is greater than the cost. Ludington paid the additional tax under protest and after the usual procedure brought this suit to recover the amount thereof. On affidavit of defense in the nature of a demurrer filed to the statement of plaintiff's claim, the court entered judgment for the defendant. The case is here on the plaintiff's writ of error.

The precise question in issue at the trial and now on review may be stated thus: Under the revenue act of 1918, where property acquired prior to March 1, 1913, at a price less than the fair market value on March 1, 1913, is sold by the taxpayer in 1919 at an actual loss, is the amount which the taxpayer may deduct by reason of such loss to be determined upon the basis of cost of the property or upon the basis of its fair market value as of March 1, 1913.

In construing the provision in question the learned trial court gave thought to the meaning of the sixteenth amendment and looked for the intention of Congress. It found that the power which the amendment granted Congress extends only to taxation of income and then only of income accrued after the adoption of the amendment; that income involves gains derived and losses sustained in the sale of property; and that by force of subsequent enactments, and particularly of the revenue act of 1918, the fair market value as of March 1, 1913, was accepted as the basis of their computation. But
22 as the Supreme Court in Goodrich vs. Edwards and Walsh
vs. Brewster, 255 U. S. 527 and 536, had construed a provision of the revenue act of 1916 (39 Stat. 756, 758) with respect to the method of ascertaining the "gain derived" from the sale of property, which was the same in substance as the provision here in question, and had limited "gain derived" to actual gain realized after March 1, 1913, and as the section here in question made the same pro-

vision for ascertaining "loss sustained" as for ascertaining "gain derived," the learned trial court viewed taxable gain and deductible loss as correlative and interdependent subjects limited alike by the same legislative intention. It therefore held that as under the decisions cited a gain derived from the sale of property means actual gain, distinguished from a statutory or fictitious gain, so loss sustained in the sale of property means actual loss, reckoned on the factors of cost price and selling price, not a loss ascertained by following literally the words of the statute. Was this the intention of Congress?

The sixteenth amendment to the Constitution was promulgated by the Secretary of State on February 25, 1913. As is familiar knowledge, when Congress in the same year came to draft income tax legislation in pursuance of the authority thereby conferred, it concluded that it could not constitutionally tax as income any increment or increase in value of property which had accrued prior to March 1, 1913. This conclusion was based upon the theory that all increment or increase in value accrued up to that date should be regarded as capital value and not income because prior to that date Congress had no power to levy an unapportioned tax upon income derived from property, as held in Pollock vs. Farmers Loan and Trust Company, 157 U. S. 429 and 158 U. S. 601. Congress consistently followed this theory in the revenue acts of 1913, 1916, 1918, and 1921 by making the fair market price or value of property as of March 1, 1913, the basis for determining the gain derived from its sale or disposition. Some of these acts, in different terms, likewise made the fair market price or value as of March 1, 1913, the basis for ascertaining "loss sustained" in the sale of property acquired before that date. It was thought, therefore, that if a gain, increment, or increase of value, accruing before March 1, 1913, was to be treated by Congress as capital value and as such not constitutionally taxable as income, it followed, quite reasonably, that the value of property on that date should likewise be treated as capital value for the purpose of ascertaining deductible loss.

But in the administration of the income tax laws it was found that sometimes the value of property of a taxpayer on March 1,
23 1913, the effective date of the act, was less than its costs, and
when later sold at a profit there immediately arose a question how in such case was the taxable gain to be ascertained, for it is obvious that if reckoned on its lesser value of that date the estimated gain would be greater than the actual gain, and entering into income, the tax would be levied upon income which, in part, was not income at all. The Internal Revenue Bureau ruled that it was the intention of Congress to tax as "net income" not simply the gain over cost but a statutory or unrealized profit resulting from taking the market value as of March 1, 1913, as the basis of the calculation. This would result, as we have said, in taxation of a greater profit than was

actually realized. When this situation came before the Supreme Court (under the revenue act of 1916), it was urged that as Congress could not constitutionally tax as income what was not in fact income, the act "must be construed so as to restrict the enactment within its constitutional limitation of power; and that Congress could not levy an income tax where no gain in fact existed as compared with original cost, because in final analysis such tax would be unconstitutional in that it would be practically upon and would have to be paid out of capital, and, therefore, be a property tax as distinguished from an income tax, and void because not apportioned as required by the constitution in respect to all direct taxes." Pollock vs. Farmers Loan and Trust Co., 158 U. S. 601, 637. Responding to this argument the Supreme Court, in the Goodrich and Walsh cases (following logically its definition of "income" in Fisner vs. Macomber, 252 U. S. 189, 207), held that where the value of previously acquired property was on March 1, 1913, less than the cost, the gain derived upon a subsequent sale should be limited to the actual gain, saying:

"It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor."

In thus construing the revenue act of 1916 the Supreme Court evidently did not regard its language so clear as to require literal interpretation, but was prompted, in accordance with its settled rule, to adopt this restricted construction in order to avoid constitutional doubt. United States vs. D. & H. Co., 213 U. S. 366, 407-408; Texas vs. F. T. R. R. Co., 238 U. S. 204, 207; Arkansas Gas Co. vs. Railroad Comm., 261 U. S. 379, 383.

While in the language of the statute in respect to a taxable gain derived from the sale of personal property there was manifestly a constitutional question, no such question can be found in its language in respect to a loss which the statute authorizes the taxpayer to de-
duct in ascertaining taxable income. No mention of losses is
24 made in the sixteenth amendment, and there is no constitu-
tional limitation upon the power of Congress in respect to the allowance of losses. Congress may allow or disallow them at will and upon any basis. Taxable gain is a constitutional concept denoting income which the taxpayer has derived, while deductible loss is a creation of Congress, varying from time to time as Congress deals with it in different ways.

Reading the decisions of the Supreme Court in the Goodrich and Walsh cases as interpretations of the law only with reference to taxable gains—the subject of deductible losses was not touched—and believing that Congress is free to make its own definition of deductible losses, it follows that in construing the provision with reference to "loss sustained" here in question, there is no constitutional limitation to be enforced and no constitutional doubt to be avoided,

and hence no reason for restricted construction or for any construction which fails to give the words of the statute their plain meaning and import. United States vs. Standard Brewery Co., 251 U. S. 210, 217; MacKenzie vs. Hare, 239 U. S. 299, 308; Caminetti vs. United States, 242 U. S. 470, 485; Russell Motor Car Co. vs. United States, 261 U. S. 514, 519.

The defendant urges upon the ground of consistency that as the Supreme Court has construed the word "gain" to mean actual gain as distinguished from statutory gain, the word "loss" should be construed to mean actual loss as distinguished from loss of the kind described in the words of the statute. Such identity of meaning in these provisions would, perhaps, be consistent if Congress had made it so. But Congress was free to make the provisions inconsistent if it chose. This is evidenced by the manner in which it has dealt with deductible losses in other income tax legislation. The income tax acts of the Civil War period, the revenue act of 1894 (held unconstitutional), the revenue act of 1913 allowed no deduction whatever for losses sustained from the sale of property of the kind involved in this case, although such losses might exceed the gains or profits derived from all other sources. The revenue act of 1916 allowed the deduction only of "the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom." The revenue act of 1918 was the first income tax law which allowed a deduction of loss however sustained, and it omitted the qualification of the word "actually" in the phrase "actually sustained" in the act of 1916 as well as the limitation therein "to an amount not exceeding the profits arising therefrom." If Congress was free to omit and to vary provisions for deductible losses in different revenue acts without relation to corresponding provisions for taxable
25 gains, we think it had power to do the same thing in this act.

Feeling that in this regard the power of Congress was not limited, we are constrained to construe the words "loss sustained" in the section in question literally and to hold that they mean just what they say, even though, as in this instance, the loss sustained, ascertained in the manner prescribed by the statute, is greater in figures than it is in money and the effect of its deduction from gross income is to decrease net income below its actual level. We are driven to this conclusion, startling as it may seem, because we can not hold that Congress did not mean what it said and also because, the language of a statute being plain and its meaning clear and the statute itself being within the constitutional authority of the law-making body which passed it, our sole function is to enforce the law according to its terms. Lake Co. vs. Rollins, 130 U. S. 662, 670, 671; Caminetti vs. United States, 242 U. S. 470, 485.

The judgment of the District Court is reversed and a new trial directed.

[File endorsement omitted.]

26 In United States Circuit Court of Appeals

[Title omitted.]

Judgment filed October 1, 1924

In error to the District Court of the United States, for the Eastern District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be, and the same is hereby reversed, and a new trial awarded.

Philadelphia, October 1, 1924.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]

27 In United States Circuit Court of Appeals

Clerk's certificate

I, Saunders Lewis, jr., clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original record and proceedings in this court in the case of Charles H. Ludington, plaintiff in error, vs. Blakely D. McCaughn, collector, defendant in error, No. 3087, on file, and now remaining among the records of the said court, in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 23rd day of October, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the United States the one hundred and forty-ninth.

[SEAL.] SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

28 In Supreme Court of the United States

Order granting petition for certiorari, filed December 1, 1924

On petition for writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Third Circuit, and of the argument of counsel thereupon had,

It is now here ordered by this court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1924

BLAKELY D. McCAUGHN, COLLECTOR OF INTERNAL REVENUE, PETITIONER
v.
CHARLES H. LUDINGTON
} No. —

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

The Solicitor General, on behalf of Blakely D. McCaughn, Collector of Internal Revenue for the First District of Pennsylvania, applies for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered on October 1, 1924, reversing the judgment of the District Court of the United States for the Eastern District of Pennsylvania.

STATEMENT OF THE CASE

Charles H. Ludington, the respondent, prior to March 1, 1913, purchased 490 shares of the first preferred stock of the United Gas & Electric Corporation and 60 shares of the 6% cumulative preferred stock of the American Cities Company at a cost of $32,500. The fair market value of said shares as of March 1,

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1913, was $37,050. In 1919 respondent sold these shares of stock for the sum of $3,866.91, thereby sustaining a loss of $28,633.09.

In making his income tax return for the year 1919 respondent claimed as a deductible loss the sum of $33,183.09, being the difference between the March 1, 1913, value of these stocks, $37,050, and the sale price of $3,866.91. Upon an audit of his return the Commissioner of Internal Revenue determined the amount of the loss as the difference between the cost, $32,500, and the sale price, $3,866.91, or a loss of $28,633.09. This resulted in increasing the tax of the respondent for said year by the sum of $3,094. This amount was paid under protest, whereupon this action was instituted for its recovery with interest.

The United States District Court for the Eastern District of Pennsylvania gave judgment for the defendant, and on writ of error the Circuit Court of Appeals for the Third Circuit reversed the judgment and directed a new trial.

Candor requires me to say that the judgment of the Circuit Court of Appeals was not in form final. Although technically it did not terminate the litigation because it was necessary that certain perfunctory proceedings should thereafter take place in the trial court, that judgment was, however, definitive as to the question of law involved. And I agree with the view expressed by counsel for the respondent in the memorandum they have filed in support of this petition, that this is a case in which the Court may very properly disregard the general rule and exercise

its undoubted power of granting a writ of certiorari before final judgment, to the end that the construction by this court of an important provision of internal revenue law may not be delayed pending purely formal proceedings in the courts below, and that the Government and the taxpayer may be spared the needless expense which a protraction of the litigation would cause. In addition, as hereinafter pointed out, there is now on the docket of this Court a case which presents another aspect of the question involved in the case at bar. If the Court should grant the writ at this stage of the litigation, it would be possible to place all phases of the question before it at the same time and not by piecemeal.

QUESTION PRESENTED

Where property acquired before March 1, 1913, at less than its value on that date was sold in 1919 for less than cost, may the taxpayer, under the Revenue Act of 1918, deduct, as loss, the difference between the selling price and the March 1, 1913, value, which amount was greater than the *actual* loss sustained, or is he limited to *actual* loss?

REVENUE ACT OF 1918

> Sec. 202. (a) That for the purpose of ascertaining the gain derived *or loss sustained* from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date * * *. (40 Stat. 1060.) (Italics ours.)

REASONS FOR GRANTING THE PETITION

1. The question involved is of general importance to the Government and to the public because of its far-reaching effect. Many cases are pending in the courts involving the same question and hundreds of cases have been settled by the Commissioner of Internal Revenue upon the basis of disallowing a loss, where the actual selling price was greater than the cost of property acquired prior to March 1, 1913. With the possible exception of the cases with respect to stock dividends, the decision of the question in issue will possibly affect more taxpayers and involve larger amounts of revenue than any tax decision within the last decade.

2. The construction placed upon the Act by the Circuit Court of Appeals with regard to "losses" is inconsistent with the construction placed upon similar language of the Revenue Act of 1916 with respect to "gains" in *Goodrich* v. *Edwards*, 255 U. S. 527, and *Walsh* v. *Brewster*, 255 U. S. 536.

3. There is now pending in this Court on appeal from the United States Court of Claims the case of *United States* v. *Harriett R. Flannery et al.*, No. 527 on the docket for the present term, in which another aspect of this same question is involved, namely, the sale by a taxpayer in the year 1919 of shares of stock owned by him on March 1, 1913, at less than the fair market price or value thereof on said date but at more than the anterior cost thereof. In the instant case there is involved the other aspect of the question, namely, sale by a taxpayer in 1919 of shares of

stock owned by him on March 1, 1913, at less than the fair market price or value thereof on said date as well as at less than the anterior cost thereof. Petitioner considers it desirable that this petition be granted in order that the instant case may be heard by this Court in connection with the *Flannery case*, so that there may be a complete adjudication by the Court of all phases of this important question.

As stated above, the respondent has filed a memorandum in which he joins the petitioner in requesting that the writ of certiorari be issued.

James M. Beck,
Solicitor General.

November, 1924.

BRIEF IN SUPPORT OF PETITION

The Revenue Act of 1916 with respect to gains and losses contained practically the same language as the Act of 1918, involved in the case at bar. That portion of the provisions of the Act of 1916 which related to gains came before this Court for construction in *Goodrich* v. *Edwards*, 255 U. S. 527, and *Walsh* v. *Brewster*, 255 U. S. 536. This Court held that "gains" as used in those provisions meant *actual* gains; that is to say, the difference between the cost of the property to the taxpayer and the price at which he sold the same. In reaching this conclusion, this Court said in *Goodrich* v. *Edwards*, *supra:*

> It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor, and we therefore agree with the Solicitor General that since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him.
>
> Section 2 (c) is applicable only where a gain over the original capital investment has been realized after March 1, 1913, from a sale or other disposition of property. (255 U. S. 535.)

Petitioner submits that it is very evident that Congress intended to establish a uniform, harmonious, and consistent basis for ascertaining gains

derived and losses sustained in computing net income for purposes of taxation in each of these Revenue Acts. It is obvious therefore that the holding of this Court in the cases of *Goodrich* v. *Edwards* and *Walsh* v. *Brewster, supra,* that the language of the Act of 1916 as applied to gains means only those *actual* gains which constitute the difference between cost and selling price necessarily requires a similar construction of this language with respect to deductible losses. That is to say, it was intended to prevent the deduction of anything except *actual* losses, viz, the difference between selling price and cost of the property sold to the taxpayer. Any other holding would make practically the same language mean one thing with respect to gains derived and another thing with respect to losses sustained, thereby nullifying the plain intent of Congress.

In view of the inconsistency which exists between the decision of the Circuit Court of Appeals in the present case and the holding of this Court in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* and of the far-reaching effect of the question involved upon the Government and the public generally, it is respectfully submitted that the petition for writ of certiorari should be granted.

James M. Beck,
Solicitor General.

November, 1924.

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AUTHORITIES CITED

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In the Supreme Court of the United States

OCTOBER TERM, 1924

BLAKELY D. MCCAUGHN, COLLECTOR OF Internal Revenue, petitioner, *v.* CHARLES H. LUDINGTON	No. 733

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR PETITIONER

The case is here on writ of certiorari to review the action of the Circuit Court of Appeals in reversing the judgment of the District Court, which District Court rendered judgment for petitioner on the suit of the respondent brought to recover certain income taxes for the year 1919 paid under protest.

THE FACTS

Prior to March 1, 1913, the respondent purchased shares of stock in certain corporations for $32,500.00. On March 1, 1913, the stock had advanced in price until its market value was $37,050.00. Respondent held it, however, until 1919,

when it had so depreciated in value that he sold it for \$3,866.91.

As a result, the Commissioner of Internal Revenue allowed him as a deduction from gross income for 1919 for "losses sustained during the taxable year and not compensated for by insurance or otherwise," the actual loss sustained, being \$28,633.09, the difference between the cost and the selling price. The respondent claimed, however, the right to deduct as a "loss" \$33,183.09, the difference between the market value of March 1, 1913, and the selling price.

The respondent brought suit in the District Court to recover the additional tax of \$3,094.00 paid under protest as a result of this difference. The District Court rendered judgment for the defendant. (*Ludington* v. *McCaughn,* 290 Fed. 604.) On appeal, the judgment was reversed by the Circuit Court of Appeals and a new trial directed. (*Ludington* v. *McCaughn,* 1 Fed. (2d Series) 689.)

The question is whether a taxpayer is entitled, under the Revenue Act of 1918, to deduct for a "loss sustained" a larger amount than his actual loss on the transaction. In other words, can the "loss sustained" be more than the actual loss?

STATUTE INVOLVED

The taxes in question were collected under the provisions of the Revenue Act of 1918. (40 Stat., Chap. 18, p. 1057, approved February 24, 1919.)

Sections 210 and 211 of the Act of 1918 levied certain income taxes to be paid annually upon the entire net income received in the preceding calendar year from all sources by every individual a citizen or resident of the United States.

Section 212 (a) provides, regarding income:

> Sec. 212 (a). That in the case of an individual the term "net income" means the gross income as defined in Section 213 less the deductions allowed by Section 214.

And Section 214 enumerates these deductions allowed, and, among others, as follows:

> Sec. 214 (a) That in computing net income there shall be allowed as deductions: * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

And Section 202 (a) contains a specific provision concerning the ascertainment of the gain derived or loss sustained from a sale of property, as follows:

> Sec. 202 (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price

or value of such property as of that date; and

(2) In the case of property acquired on or after that date the cost thereof, or the inventory value if the inventory is made in accordance with Section 203.

ARGUMENT

Where a taxpayer sells property at a loss is he entitled to a deduction of a greater sum than the actual loss on the transaction for a "loss sustained" under the provisions of the Revenue Act of 1918?

This question is in principle that recently argued by the Government in the case of *United States* v. *Flannery,* and on the general question as to the true construction of the statute we refer to our brief in that case.

"Loss sustained" means actual loss suffered

The taxpayer contends that as he *might have been able to sell* the stock on March 1, 1913, for $37,050.00, he should deduct this sale price from this figure and call his "loss sustained" $33,-183.09.

This contention of the taxpayer is controverted by the direct wording of the statute. The words "loss sustained" in Section 214 of the Act would not seem to need definition. "Loss" is a word which is so simple and certain and well understood in its meaning that it is difficult to define. It suffices to say it is the opposite of gain, a deprivation. The two words "loss" and "gain" are mutually exclusive. The word "sustained" is also simple and well understood.

It means suffered or undergone. Every word in an act is considered as being used to express some definite meaning and purpose. The office of the word "sustained" is clearly to emphasize the use of the word "loss," in the sense of an actual loss suffered, and necessarily excludes the sense of a mere reduced valuation, which would be only a fictitious or paper claim of a loss. It is not possible to read "loss sustained" to mean any larger sum than the taxpayer has been actually deprived of. A tax law is practical and deals with realities and not "might-have-beens."

To constitute a loss, there must be a realization of loss or deprivation of property, by sale of the property for less than it cost. The cost of acquisition and the proceeds of sale are the determining factors of loss and also of gain.

Men who sell property consider that the difference between the selling price and what the property cost one, is what he has gained or lost. Such is the common-sense, practical, ordinary, and exact meaning which this Court has given to the word "loss."

> It can not be said that a conversion of capital assets invariably produces income. *If sold at less than cost, it produces rather loss or outgo. Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, 185. (Italics ours.)

The same practical definition was given the word "gain," which is the direct converse of "loss," in the *Goodrich* case:

> It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor. *Goodrich* v. *Edwards,* 255 U. S. 527, 535.

A change in market valuation of property, without realization by either acquisition or sale, is a false factor in the computation of gain or loss and has no place therein. Before it could be said that there was a deductible "loss sustained," it must appear, by a comparison of the selling price with the cost of the property, that there was an actual loss. This is the ordinary, well-understood and exact meaning of the word which has been accepted without question and approved by this Court. It is also the practical conception of a practical world. While there are a few speculators and investors, who idly spend their time in counting sadly the "gains" they might have made if they had sold at some earlier time, or in joyful reflections as to the losses they have escaped by not selling, yet the practical man gives little heed to temporary fluctuations in market values which are intermediate between the time he bought and the time he sold. Certainly, a taxing law is not less practical. Both the law and the business world recognize that these quoted market values are often highly conjectural. To offer to sell is too often to find that the market value is fictitious. Is it likely that Congress was blind to this fact?

This definition of the word "loss" in the act is borne out by a consideration of the entire act.

Only actual losses are allowed to be deducted

Taxation is a very practical matter. Indeed, it is the most practical matter known to Government. It concerns itself with the substance of the thing upon which it imposes the tax.

In all the Income Tax Acts certain deductions are allowed the taxpayer from his gross income in order to determine his net income. It is natural and right that the taxpayer should be allowed to deduct the expenses of his business and the losses and depreciation he has suffered. But there is no possible reason why he should be permitted to deduct any conjectural loss, or what is commonly known as a paper loss. His gross income is measured by his actual receipts, and his net income is intended to be his actual gains, profits, or income. So that if he were permitted to deduct paper or conjectural losses the resultant would be less than his real net income.

In Section 212 (a) of the Act, it states:

> That in the case of an individual the term "net income" means the gross income as defined in Section 213, less the deductions allowed by Section 214.

Here we have the statement in the Act of why the deductions are allowed. From the gross income such deductions are allowed as are necessary

to give the taxpayer's net income. This is the definite statement of the purpose and intention of Congress regarding the deductions.

Upon considering the deductions allowed to a taxpayer (Revenue Act, 1918, Sec. 214, clauses (1) to (12)), it is seen they are of three groups:

(a) Moneys paid out in the business.

These include (1) expenses paid, (2) interest paid, (3) taxes paid, (11) contributions to charity.

(b) Losses sustained.

(4) Losses sustained in the business, (5) losses sustained in other transactions entered into for profit, (6) other losses sustained arising from fires, storms, shipwreck, or other casualty, or theft.

(c) Decrease in value of property.

(7) Worthless debts charged off, (8) allowance for exhaustion, wear, tear, and obsolescence of property, (9) amortization of facilities provided for war purposes, (10) depletion of mines, oil and gas wells, and timber, (12) loss resulting from reduction of value of inventory.

In none of these can the deduction be for more than the actual money outlay, or actual money loss suffered by the taxpayer. These deductions are all limited and explained either in the Act itself or in the Regulations which the Commissioner is authorized to make. Thus in all three of the clauses relating to " losses sustained " the

law states the limitation "if not compensated for by insurance or otherwise."

And it is by allowing only actual losses to be deducted that the net income can be correctly arrived at. Congress has sought by the Act to arrive at the true net income of the taxpayer, and to levy the tax on that. Congress has sought to determine the actual net income of the taxpayer. And the deductions allowed are not gratuities. In no case is a deduction allowed which is not necessary in order fairly and justly to arrive at the actual net income of the taxpayer.

So that the whole Act, the exact wording of the statute, and all particulars of the deductions allowed, show that a deduction is allowed only for the actual loss which has been sustained or suffered.

It should be noted that the taxpayer, by his contention, does not say he was charged with a gain he did not have, nor does he say he sustained a loss which he was not permitted to deduct. The net income, as figured by the Commissioner, correctly states his net income. But the respondent seeks to construe one sentence of the act so as to allow him to pay taxes on *less* than his net income. In other words, to give him a gratuity, as compared with other taxpayers, who have sustained no losses but who pay a tax upon their actual net income. And the basis for his contention for this preferential treatment is an unreasonably literal

construction of one sentence of the act divorced from its context. His construction is inconsistent with the other parts of the act and with the whole meaning and purpose of the act. The allowance of this taxpayer's contention would be an injustice to the great mass of taxpayers not similarly situated. The act does not admit of such a construction, and Congress never intended such an inequality in meeting the burdens of taxation.

The Income Tax Act levies the tax upon the net income of all persons and seeks to treat all equally. The construction contended for by respondent sticks in the bark, does violence to the spirit of equality, and is inconsistent with the other parts of the act as well as its meaning and purpose.

This Court has held that loss and gain mean actual loss and actual gain

The Act also provides:

> SEC. 202(a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date.

This Court construed these sections of the law in the 1916 Act, in the cases of *Goodrich* v. *Edwards,* 255 U. S. 527, and *Walsh* v. *Brewster,*

255 U. S. 536. In those cases the question was as to gains, and it was held that by gains was meant actual gains. After discussing the matter, the Court said:

> It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor, and we therefore agree with the Solicitor General that since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him. [Italics by the Court.]
>
> *Goodrich* v. *Edwards,* 255 U. S. 527, 535.
> *Walsh* v. *Brewster,* 255 U. S. 536.

While the question in those cases was as to the gain derived, it is impossible for one to determine his gains without at the same time determining his losses. Loss is the converse of gain, and the figures which determine if there is a gain, at the same time determine if there is a loss. Losses and gains are the factors which bring about the ultimate result.

It was said by this Court in construing the 1909 Act:

> Understanding the term [income] in this natural and obvious sense, it can not be said that a conversion of capital assets invariably produces income. *If sold at less than cost, it produces rather loss or outgo.*

Doyle v. *Mitchell Bros. Co.*, 247 U. S. 179, 185. [Italics ours.]

The sale of an article for less than cost produces a loss. This definition of loss was before the *Goodrich case.* And the *Goodrich* and *Walsh* decisions as to gains logically follow this statement. In fact, the positive definition of either gain or loss just as positively determines the definition of the other word. In the *Doyle case* it was said that the sale of an article for less than its cost produces loss. In the *Goodrich* and *Walsh cases* it was said that the sale of an article for more than its cost produces gain.

The wording of the Act shows that Congress intended these words " gain derived " and " loss sustained " to be construed as correlative and interdependent. The statute reads: " for the purpose of ascertaining the gain derived or loss sustained." The use of these words in one sentence separated only by the disjunctive " or " shows that Congress intended them to be construed together. They are so closely united in this sentence that not even the word " the " is repeated, but grammatically the word " the " modifies both words " gain " and " loss." So that it is not possible to use these words and show more positively that the same modifying words are intended to apply to one as to the other.

It is not reasonable to argue that Congress by this use of these words intended to say " for the

purpose of ascertaining the (*actual*) gain derived or (*paper* or *fictitious*) loss sustained." Such an interpretation would do violence to the English language. And as this Court held in the *Goodrich* and *Walsh cases* that "gain derived" means actual gain, it necessarily follows that "loss sustained" means actual loss, as it said in the *Doyle case*.

Then, too, the ordinary, common, and unquestioned meaning of the words "gain" and "loss" and their use by Congress in this sentence separated by the disjunctive "or" compel the conclusion that the same transaction can not result in a gain *and* a loss. If there is a gain in the transaction, there can not be a loss; and if there is a loss, there can not be a gain also in the same transaction.

But if respondent's contention were allowed, there would be both a gain and a loss in many transactions.

In *Doyle* v. *Mitchell Bros. Company*, 247 U. S. 179, 183, the Court, after analyzing the provisions of the 1909 Act, said:

> The suggestion that the entire proceeds of the conversion should be still treated as the same capital, changed only in form and containing no element of income although including an increment of value, we reject at once as inconsistent with the general purpose of the Act. Selling for profit is too familiar a business transaction to per-

> mit us to suppose that it was intended to be omitted from consideration in an act for taxing the doing of business in corporate form upon the basis of income received "from all sources."

And after quoting the definition of income from *Stratton's Independence* v. *Howbert*, the Court continued (p. 185):

> Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo.

In the case of *Hays* v. *Gauley Mountain Coal Company*, 247 U. S. 189, which arose under the same Act and was decided on the same day, this Court said (p. 192):

> That the sale resulted in a gain or profit to the exent of $210,000, the difference between the buying and selling prices, is not to be doubted.

These cases show that this Court understood the words gain and loss in the Income Acts in this common sense, ordinary, practical meaning, when there was no question of a constitutional limitation involved. So that the decisions in the *Goodrich* and *Walsh cases* were not a departure, but were the natural and logical continuation of, and conclusion from, the previous statements and expressions of this Court.

After the decisions in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster,* the Revenue Act of 1921 was passed by Congress. In this Act the provision regarding deduction for such a loss was the same. But the provision regarding " the basis for ascertaining the gain derived or loss sustained " was elaborated and made more definite.

The change in the 1921 Act is not a fundamental modification of the law but merely a more detailed statement of its application.

In the Report of the Committee on Ways and Means of the House of Representatives by Mr. Fordney reporting this bill, it is said:

> **Basis for Determining Gain or Loss**
>
> SECTION 203. In the case of property acquired before March 1, 1913, under existing law, the basis for determining gain or loss is the fair market price or value of such property as of that date. The decision of the Supreme Court in the case of *Merchants Loan & Trust Co.* v. *Smietanka* (decided March 28, 1921) *makes necessary not a fundamental modification of that rule but a more detailed statement of its application.* [Italics ours.]
>
> The proposed bill gives explicit effect to the doctrine approved in that decision; provides that the general basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property shall be the cost of such property;

> but that in the case of property acquired before March 1, 1913, (1) if its fair market price or value as of March 1, 1913, is in excess of the cost, the gain to be included in the gross income shall be the excess of the amount realized therefor over the fair market price or value as of March 1, 1913; (2) if its fair market price or value as of March 1, 1913, is lower than cost, the deductible loss shall be the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and (3) if the amount realized therefor is more than cost but less than its fair market price or value as of March 1, 1913, or less than cost but more than such fair market price or value, no gain or loss shall be recognized. (Report of Committee on Ways and Means, by Mr. Fordney, p. 9, 1921 Act.)

So that while the clause in question was stated in more detail, this was considered by Congress *"not a fundamental modification of that rule but a more detailed statement of its application."* The law was not changed, but certain particulars were stated in detail, which before had been left to inference. And, always, in this as in the previous acts, loss and gain are considered correlative and interdependent.

An examination of the Goodrich case shows that only actual gains and losses are intended.

It seems desirable to examine the case of *Goodrich* v. *Edwards, supra,* to see what was the

concession by the Solicitor General in that case, and what was said by this Court. The brief filed by the Solicitor General contains a very clear statement of the facts and the law applicable thereto, and we print it as an appendix.

My distinguished predecessor's brief stated the Government's contention, then and now, very clearly. The interpretation of the law by the Commissioner required the taxation of what were not gains or income, and that interpretation could not be allowed to stand. The Solicitor General, therefore, conceded that the Government was wrong in this contention. The use of the words gain and loss in their common, ordinary, natural meaning made the act as a whole harmonious, gave force and effect to every part, and this construction made the act as a whole constitutional and valid.

This was the view taken by this Court which stated its position as follows:

> As to the second payment. The Government confesses error in the judgment with respect to this assessment. The stock was sold in the year for which the tax was assessed for $22,253.75 less than its value when it was acquired but for $120,710.75 more than its value on March 1, 1913, and the tax was assessed on the latter amount.
>
> The act under which the assessment was made provides that the net income of a "taxable person shall include gains, profits, and income derived from * * *

sales, or dealings in property, whether real or personal, * * * gains or profits and income derived from any source whatever." (39 Stat. 757; [illegible] Stat. 300, 307.)

Section 2 (c) of this same act provides that "for the purpose of ascertaining the gain derived from a sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived."

And the definition of "income" approved by this court is: "'The gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." (*Eisner* v. *Macomber*, 252 U. S. 189, 207.)

It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor, and we therefore agree with the Solicitor General that since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him.

Section 2 (c) is applicable only where a gain over the original capital investment has been realized after March 1, 1913, from a sale or other disposition of prop-

erty. (*Goodrich* v. *Edwards,* 255 U. S. 527, 534, 535.)

And on the authority of this case on the same day the Court decided the case of *Walsh* v. *Brewster,* 255 U. S. 536.

It will be observed that this Court raised no constitutional question on this phase of these cases and decided them on the very simple reasoning:

> It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor.

The Circuit Court of Appeals in its opinion in the instant case seemed to think that this Court had been forced to decide some constitutional question in the Goodrich case and was compelled to give a forced and unintended meaning to the act in order to construe it as constitutional.

But it is readily seen that this is not the fact. The difficulty arose because the Commissioner had interpreted the law incorrectly, and the Solicitor General conceded this. This Court did not find it necessary to pass upon any constitutional question, or any canons of interpretation of constitutional questions, for it found the position of the Solicitor General in his concession was the natural and correct construction of the act.

The construction given to existing laws by the executive officials charged with their enforcement is entitled to great weight.

Ever since the decision of this Court in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster*, the administrative department of the Government has construed the word loss as meaning actual loss.

Since that decision, in accordance with the reasoning of this Court, actual losses have been allowed as deductions. Many millions of dollars which had been collected were refunded or allowed as deductions.

Immediately after the decision in the *Goodrich* and *Walsh* cases, the Treasury Department issued Treasury Decision 3206, which reads, in part, as follows (23 T. D. 764):

> Regulations 45 (1920 Edition) are hereby amended in order that the rule announced by the Supreme Court in the cases of *Goodrich* v. *Edwards* and *Brewster* v. *Walsh,* respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. * * *

The Attorney General also gave his opinion that this was the law and the correct construction of the law as interpreted by this Court in the *Goodrich* and *Walsh* cases. (33 Opp. Atty. Genl. 291.)

That has been the construction given to the law for nearly four years now, and that construction should not be set aside unless the law compels it.

It is difficult to estimate the number of cases which would be overturned by a change in the construction at this time. They would need to be reopened, refunds allowed, and everything recomputed on a new basis. The amount involved in the case at bar is not large, but it is estimated that the amount involved to the Government in the decision of his question amounts to many million dollars. Now to set aside these accepted rulings means uncertainty, confusion, and loss. Only when the law imperatively compels it should the Court require it.

The State of New York has an Income Tax Law, in which the wording of these sections of the Act of 1918 is followed except that January 1, 1919, is used instead of March 1, 1913. In the case of *People ex rel. Klauber* v. *Wendell* (196 App. Div. 827; 188 N. Y. Supp. 301) the Supreme Court considered a case exactly like the *Goodrich* and *Walsh* cases, and came independently to the same conclusion that this Court announced in the *Goodrich* and *Walsh* cases. The Court says:

> Section 353 [corresponding to Section 202 (a) of the Federal Act] speaks of the "gain derived" from the sale of property, and that clearly means such "gain" as is described and referred to in Section 359 [corresponding to Section 213 of the Federal Act]. And Section 353 then provides that, for the purpose of ascertaining such gain, the basis shall be, in case of property acquired before 1919 [corresponding to March 1, 1913, of the Federal Act], the

market value thereof on January 1st of that year. The two sections read together to my mind clearly indicate that there must first be a gain, as indicated in Section 359, as between the purchase price and selling price, and then, in cases where there is such a gain, the portion thereof subject to taxation shall be ascertained by deducting the market value of the property on January 1, 1919, from its selling price. The Legislature did not intend to treat that as a gain which was an actual loss, simply because there was an appreciation in value after January 1, 1919, but in cases where there was an actual gain in the selling price over the cost price to include as gross income only that portion of such gain as accrued after January 1, 1919. That was the year when the Income Tax Law became effective, and the legislative purpose clearly was not to tax any gains or profits which might have accrued before that year, but to include in gross incomes only that portion of the gains or profits which accrued during the taxable period in cases where such gains or profits had actually been derived.

* * * * *

The manifest purpose of the Congress, therefore, as it seems to me, was to exclude all gains or profits which accrued prior to the constitutional amendment, and which were realized by sales or transactions thereafter, making only such portion of such gains or profits as accrued after the amendment subject to the tax. The purpose

was not to make an appreciation in the value of property subsequent to the amendment the subject of taxation, irrespective of whether or not the entire transaction involved a gain or loss. Of course the state Legislature is not fettered by constitutional restrictions, as was the Congress; but, having adopted the act of Congress substantially in haec verba, it is reasonable to assume that the purpose of the two enactments was the same, although the motive and necessity for such purpose did not exist in respect to the state enactment. I conclude that full effect and meaning may be given to section 353 of the Tax Law by applying it only to those cases where a sale or other transaction results in an actual gain or profit and the history and origin of the statute, as well as a reasonable construction thereof, and a due regard both to the equities of the taxpayers and justice to the state all combine to indicate that such was the legislative purpose.

Since writing the foregoing opinion the United States Supreme Court in the cases of *Goodrich* v. *Edwards* (255 U. S. 527) and *Walsh* v. *Brewster* (255 U. S. 536) has, without reference to constitutional requirements, construed the federal statute as the state statute is here construed. (*People ex rel. Klauber* v. *Wednell,* 196 App. Div. 827; 188 N. Y. Supp. 301, 302–304.)

And this was affirmed by the Court of Appeals of New York. (*People ex rel. Klauber* v. *Wendell,* 232 N. Y. 549; 134 N. E. 567.)

Later there came before that court the same question as is before this Court in the case at bar, on the question of the amount of the loss which could be deducted when two short-sale transactions were entered into before 1919 and closed out at a loss during 1919. The Court said:

> The two short-sale transactions were entered into for profit, and loss was incurred in each transaction, part of which was sustained during the taxable year. Under the statute and the decision in the *Klauber case* to justify a deduction there must be a loss on the transaction; but the deduction allowed can not be greater than the actual loss incurred on the whole transaction nor than the loss "sustained during the taxable year"—that is, after January 1, 1919. In order to determine the actual loss the price at which the stocks were sold short must be compared with the price at which they were bought in when he covered. To ascertain the loss in 1919 the market value of the securities on January 1, 1919, must be compared with the price when the stocks were bought in.
>
> * * * * *
>
> This construction as here given the statute finds support in decisions of the Supreme Court of the United States *Goodrich* v. *Edwards,* 255 U. S. 527;

Walsh v. *Brewster,* 255 U. S. 536; *Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S. 509), in which the Federal Income Tax Law, containing provisions in all essentials similar to our state Income Tax Act of 1916, as amended in 1917, known as the Revenue Acts of 1916 and 1917 (39 Stat. 756, c. 463, as amended by 40 Stat. 300, c. 63), except that the initial date is March 1, 1913, is construed. In those cases the court recognizes that gains or losses which accrued before March 1, 1913, were excluded in calculating the net income, and the fair market value on March 1, 1913, of the property dealt in, is the basis for determining the gain or loss.

The comptroller has made the proper allowances, excepting as to the second item the loss can not be greater than the actual loss, and should therefore be $13,407.50, rather than as allowed, $15,702.50. (*People ex rel. Keim* v. *Wendell,* 200 App. Div. 388; 193 N. Y. Supp. 143, 148, 149.)

It will be noted that that court after citing the decisions of this Court, says, *supra*:

In those cases the court recognizes that gains or *losses,* which accrued before March 1, 1913, were excluded in calculating the net income, and the fair market value on March 1, 1913, of the property dealt in, is the basis for determining the gain or loss. (Italics ours.)

In other words, the Supreme Court of the State of New York construes the decisions of this Court the same way they have been construed by the Solicitor General, the Attorney General, the Treasury Department, and the Commissioner of Internal Revenue of the United States, as settling the rule for both gains *and* losses.

Later another case came before that court involving losses, and was decided the same way.

Property purchased by the taxpayer had increased in value a certain amount until January 1, 1919 (the date under the New York Act corresponding to the date of March 1, 1913, under the Federal law). This property was sold in 1919 for a much smaller sum but still at a profit to the taxpayer over the cost. The State Tax Commission assessed an income tax on the profit derived and refused to allow a deduction for the alleged loss for the sale at less than the value of January 1, 1919. This determination of the State Tax Commission was confirmed by the Supreme Court, the law evidently being considered settled in New York, with regard to both gains and losses in correspondence with the decisions of this Court, and partly, at least, in reliance thereon. The opinion of the Supreme Court is brief:

> Per curiam: Determination confirmed, with $50 costs and disbursements, upon the authority of *People ex rel. Klauber* v. *Wendell* (196 App. Div. 827; 188 N. Y.

Supp. 301; affirmed 232 N. Y. 549; 134 N. E. 567; and *People ex rel. Keim* v. *Wendell,* 220 App. Div. 388; 193 N. Y. Supp. 143). (*Bush* v. *Law et al., State Tax Commission,* 206 App. Div. 800; 201 N. Y. Supp. 513.)

CONCLUSION

It was said by this Court that:

> Judicial decisions affecting the business interests of the country should not be disturbed except for most cogent reasons. *National Bank* v. *Whitney,* 103 U. S. 99, 102.

That is very applicable to this case. While the *Goodrich* and *Walsh cases* were concerned with gains, they necessarily determined the rule for losses. The reasoning of the Court in those cases required the rule which has been followed by the Government in all the cases arising since that time. A change in that rule now would mean great disturbance as well as injustice and unfairness to the great mass of taxpayers of the country.

It is submitted that a decision in favor of the respondent would require a technical construction of one sentence of the act, and be contrary to every other part of the act, would be contrary to the intention of Congress as expressed in the act, would be contrary to the reasoning of the decisions of this Court, would be an unfair preference

to the respondent, and, therefore, unfair and unjust to the other taxpayers.

Respectfully submitted.

JAMES M. BECK,
Solicitor General.

ROBERT P. REEDER,
FREDERICK W. DEWART,
Of Counsel.

January, 1925.

APPENDIX

Extract from brief of former Solicitor General Frierson for defendant in error in *Goodrich* v. *Edwards*, pp. 58–65:

> The application of the law to the two transactions involved in this case.
>
> So far as plaintiff in error seeks to recover the taxes paid on account of the United Verde Extension Mining Company stock transaction there is no difficulty. He purchased the shares in 1912 for $500 and sold them in 1916 for $13,931.22, making a clear gain on the transaction of $13,431.22. It appears, however, that the stock from the time he bought it increased in value, so that on March 1, 1913, it was worth $695. The Commissioner of Internal Revenue, correctly construing the law to entitle him to withdraw as capital from the proceeds of sale the value of his stock on March 1, 1913, deducted $695 instead of the original purchase price and collected the tax on the remainder, or $13,236.22. For the reasons above stated, plaintiff in error was plainly liable for the tax so collected.

With respect to the B. F. Goodrich stock, the situation is different. Plaintiff in error acquired this stock in 1912. It was acquired in a transaction in which he received this stock and a certain amount of cash in exchange for other stocks, which he had previously acquired by gift and bequest. He thus received 3,600 shares, which were worth $81 per share, or $291,600. He sold them in 1916 for $269,346.25, making a net loss on the entire transaction of $22,253.75. But it appears that after he acquired these shares their market value very rapidly declined until on March 1, 1913, the stock of the company sold on the New York Stock Exchange at something in excess of $41 per share. On this basis the Commissioner of Internal Revenue determined that the total value on March 1, 1913, of plaintiff in error's 3,600 shares was $148,635.50. Holding that this was the capital value which was entitled to be withdrawn, as capital from the proceeds of sale, he deducted that amount from the selling price of $269,346.25 and collected taxes on the balance, or $120,710.75. It will be seen that on the entire transaction there was no gain, but, on the contrary, a loss of more than $22,000. The question is whether in such a case any taxable income was received. The theory of the commissioner was that the act of Congress capitalized the assets of a taxpayer at their value as it existed on March 1, 1913. In other words, he ruled that the value, as of that date, must always

control, and that in all cases the difference between this value and a higher selling price is income received when the sale is made.

If this construction of the law is correct a serious constitutional question arises. Whatever gains are made by selling property resulted from three acts—acquisition, holding, and selling. These three acts together resulted in a gain or a loss, according as the selling price is more or less than the acquisition price. It is said, therefore, that unless the entire transaction composed of the three acts mentioned results in a gain there is, in fact, no income. It is true that between the date of acquisition and the date of sale the market price of the property may have fluctuated, so that there may have been times when a sale could have been made at a profit; but if the owner did not choose to sell and take his profit, no income, in fact, resulted from his mere ability to have done so. On the other hand, there may have been times when, if the owner had sold, his loss would have been greater than it was at a later date when he actually sold. But it is said that he was not required to sell when the price was at its lowest and take his loss, and that if he did not do so the question as to whether he finally made a profit or suffered a loss must be determined by comparing the purchasing and selling prices. In other words, the contention is that, under the commissioner's construction of the law, something is taxed

which is not, in fact, income and which Congress was therefore without the power to tax except by apportionment.

After a careful study of the statute the Solicitor General is forced to the conclusion that the commissioner has erroneously construed the statute. It clearly imposes the tax only on *gains* that are derived from the sale of property. It can not be said that there has been a gain resulting from a sale of property at less than it cost, no matter how long an interval may have intervened between the purchase and the sale. The error consists in giving too broad a scope to the rule laid down by the statute for determining the amount of taxable gain derived from sales made during a particular year. From the beginning the income tax acts had imposed a tax only upon gains derived from sale. As shown above, there had been much discussion and difference of opinion as to whether all such gains should be taxed in the year in which received. It was contended that it would be unjust to tax all of such gains when they had resulted from a gradual increase in values during a long period of years. Following the act of 1867, it was at first thought that such gains should be taxed only when the transaction from which they resulted both began and ended in the tax year, or, at least, when the property had been purchased only a short time before the beginning of that year. There was also a doubt of the power of Congress to

tax that portion of such gains which would be represented by the increase in value which had occurred prior to the adoption of the sixteenth amendment.

After much discussion Congress determined that it would not confine the tax to gains made in transactions beginning and ending in the particular year or within any fixed and arbitrary time before that year but that it would simply exclude so much of the gains as could be said to have resulted from increases in value prior to March 1, 1913, practically the date of the adoption of the sixteenth amendment. There had also been a difference of opinion as to how, in such cases, the gains should be apportioned between taxed and nontaxed gains. Under the act of 1909 the Internal Revenue Department had adopted a prorating method, according to the number of years the property was held before and after the effective date of the act. Congress apparently regarded this method unsatisfactory, and instead concluded that the better plan was to ascertain the amount of gains resulting from increase in value before March 1, 1913, by comparing the value on that date with the original cost price. When, therefore, it adopted the provision, which will be quoted below, it was dealing with the question as to how ascertained gains should be divided for the purpose of taxation under this act, or for ascertaining the income which Congress intended should

be taxed in a particular year. For this purpose it used the following language:

"For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (39 Stat., c. 463, sec. 2 (c), p. 758.)

It seems difficult to escape the conclusion that this provision can have no application until it is first ascertained, by comparing the purchase and selling prices, that there has been an actual gain. When this has been ascertained, the value of the property on March 1, 1913, is to be taken as including that portion of the increase in value finally realized by a sale which occurred subsequent to that date. But when the selling price is less than the purchase price, there has been a loss instead of a gain, and hence there is nothing to which the value on March 1, 1913, can be applied.

Under a proper construction of the act, therefore, it must be conceded that the plaintiff in error was not liable for a tax on account of his transaction in the B. F. Goodrich Company stock.

Having made this concession, however, it is proper to make clear the Government's view with respect to a similar and related

matter. As shown above, losses sustained in business or trade or in transactions entered into for profit are, under certain conditions, permitted to be deducted. Where these losses are allowed and have resulted from the sale of property purchased before March 1, 1913, Congress has made provision for ascertaining the amounts of such losses that may be deducted in much the same language used in providing for ascertaining the amount of income from such sources to be taxed in a particular year. The provision is as follows:

"*Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained." (39 Stat., c. 463, p. 759.)

This provision, therefore, must be construed as it has been conceded the similar provision relating to income is to be construed—that is, it must first be ascertained by comparing the purchase and selling prices that a loss on the entire transaction has been sustained. When this fact is ascertained we look to the value of the property on March 1, 1913, to determine how much of the loss resulted from a decrease in value prior to that time. Thus.

if property was bought in 1910 for $2,000 and sold in 1916 for $1,000, there was a loss of $1,000. Since all gains, under similar circumstances, are not taxed as income, there was a similar purpose not to allow all such losses. Therefore, if it appeared that on March 1, 1913, the value of the property had decreased until it was worth only $1,500, $500 of the entire loss would be regarded as having resulted from decrease in value occuring before that date, and hence only the remaining $500 of the loss would be allowed as a deduction. On the other hand, if the value of this property had increased until it was worth $2,500 on March 1, 1913, and had then decreased in value until it was finally sold for $1,000, the actual loss would still be $1,000; but the fact that all of this decrease had occurred since March 1, 1913, would be established by the advanced value as of that date, and hence the entire $1,000 would be deductible, and the taxpayer would not be entitled to deduct the difference between the full market value on March 1, 1913, and the selling price. Again, if it appeared that the value had decreased until on March 1, 1913, the property was worth only $1,000 and was later sold for $1,000, there would still be a loss of $1,000; but no deduction would be allowed because the market value of $1,000 on March 1, 1913, would establish the fact that the entire loss had resulted from a decrease in value occurring before that date.

In the present case, if it could be said that in any event the plaintiff in error could deduct from the income derived from one transaction the losses suffered through the other he would not be entitled to a deduction. The reason is that while he suffered a loss on the entire transaction, the value of the stocks had so greatly decreased before March 1, 1913, that if he had sold then his loss would have been very much greater. He did not choose to take his loss at that time, but held the stock for a higher price, which he finally obtained. In other words, the entire decrease in value which resulted in his final loss occurred prior to March 1, 1913. There was thereafter no decrease in value which resulted in a loss, but, on the contrary, an increase in price which overcame, in part, the previous decrease, and there was no loss occurring under the terms of the act after March 1, 1913, which can be deducted.

From what has been said, it results:

1. The taxes paid on the gain derived from the sale of the mining company stock were properly collected.

2. There was no gain resulting from the sale of the B. F. Goodrich Company stock, and the taxes collected on account of that transaction were improperly collected.

3. The plaintiff in error is not entitled to any deduction from the income derived from the first transaction on account of losses sustained in the second.

O

Supreme Court of the United States

OCTOBER TERM, 1924

No. 733

BLAKELY D. McCAUGHN, Collector of Internal Revenue,
Plaintiff-in-error,

vs.

CHARLES H. LUDINGTON,
Defendant-in-error.

IN ERROR TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MEMORANDUM OF PLAINTIFF BELOW IN SUPPORT OF THE APPLICATION BY THE COLLECTOR OF INTERNAL REVENUE FOR A WRIT OF CERTIORARI.

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SUPREME COURT OF THE UNITED STATES.

No. , October Term, 1924.

BLAKELY D. MCCAUGHN, Collector of Internal Revenue,
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vs.

CHARLES H. LUDINGTON,
Defendant-in-Error.

IN ERROR TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MEMORANDUM OF PLAINTIFF BELOW IN SUPPORT OF THE APPLICATION BY THE COLLECTOR OF INTERNAL REVENUE FOR A WRIT OF CERTIORARI.

The defendant below, the Collector of Internal Revenue, now applies to the court for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit to review a decision of that court reversing the judgment of the District Court in favor of the Collector and awarding a new trial, and the defendant concurs in the view that the important question of statutory interpretation should be now reviewed by this court.

The question passed upon in both courts below was one of law, as the opinions clearly show. If the question of law was rightly decided by the District Court, the defendant below was entitled to judgment. If, on the other hand, it was rightly decided by the Circuit Court of Appeals, the plaintiff was entitled to judgment. The new trial directed by the court can, therefore, in this case amount to nothing more than the formal enforcement of the mandate of the Circuit Court of Appeals, a perfunctory new trial and a final judgment entered thereon as matter of course. It would then be necessary for the Collector of Internal Revenue to sue out a writ of error to the Circuit Court of Appeals for the Third Circuit, and that court would thereupon, of course, affirm the judgment, also as a matter of course in view of its ruling on the present writ. Hence that proceeding would in fact be also merely *pro forma.*

It is manifest from the foregoing considerations that no useful purpose can be served by postponing review of the decision of the Circuit Court of Appeals by this court, which alone can finally and authoritatively settle the question of statutory interpretation involved.

The question of law thus presented is adequately stated in the petition for the writ of certiorari and the accompanying papers heretofore filed with the court by the Department of Justice on behalf of the Collector of Internal Revenue; it has been differently decided by different courts of inferior jurisdiction, and it is important to the due and prompt administration of justice that an authoritative decision be pronounced by this court as soon as may be.

This court, of course, has power to issue its writ of certiorari to the Circuit Court of Appeals to the end that the cause may be brought here at once. The fact that the judgment of the Circuit Court of Appeals is interlocutory clearly does not constitute a bar to such a procedure. *Forsythe* v. *Hammond*, 166 U. S. 506; *Hanover Milling Co.* v. *Metcalf*, 240 U. S. 403, 408-9; *Hamilton Shoe Co.* v. *Wolff Bros.*, 240 U. S. 251, 258. The judgment here is only interlocutory in form; in effect it is final. Further proceedings upon it would only result in unnecessary proceedings, expense and delay, and, in the meanwhile, leave the law in a state of uncertainty as to an important question in the administration and enforcement of the revenue laws.

It is submitted that it is to the interest, not only of the Government, but of the individual taxpayers as well, that such a question of national and general importance be promptly set at rest.

The question now before the court in the case of *Flannery* v. *United States*, on appeal from the Court of Claims, is similar to, but not the same as, the question involved herein. In the case at bar the taxpayer sold the securities at less than their cost to him, which was in turn less than their value on March 1, 1913. In the Flannery case, however, the taxpayer sold the securities at more than cost, but less than their value on March 1, 1913. In order that all the phases of the situation affecting the tax statute in question may be adequately before the court, it is believed that it will be helpful and in the interest of justice if this case as well as the Flannery case be heard by the court.

For the foregoing reasons the defendant joins in the application for a writ of certiorari and prays that the writ may issue to the Circuit Court of Appeals for the Third Circuit, as prayed for.

Respectfully submitted,

William D. Guthrie,
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Ralph B. Ewans,
Counsel for the Defendant-in-Error.

Supreme Court of the United States

October Term, 1924, No. 733

BLAKELY D. McCAUGHN, Collector of Internal Revenue,
Petitioner,

against

CHARLES H. LUDINGTON,
Respondent.

Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

MOTION TO ADVANCE

Supreme Court of the United States

October Term, 1924, No. 733

Blakely D. McCaughn, Collector of Internal Revenue,
Petitioner,

against

Charles H. Ludington,
Respondent.

Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

Motion to Advance.

The above named respondent, Charles H. Ludington, by his counsel, respectfully requests this Honorable Court to advance the above-entitled cause and to set the same for hearing on January 5, 1925.

The reasons for this request are as follows:

The controversy arises in an action to recover income taxes paid under due protest and involves the construction of sections 202-a and 214-a of the Revenue Act of 1918 (c. 18, 40 Stat. 1060, 1067), which fix the losses deductible from gross income under said Act. The Circuit Court of Appeals herein, reversing the District Court,

held that the market price or value as of March 1, 1913, was the proper statutory basis for determining the deductible loss, and hence that where property was acquired prior to March 1, 1913, at a price less than the fair market value on March 1, 1913, and thereafter sold by the taxpayer in 1919 at a less price than the value of 1913, the taxpayer was entitled to deduct the difference between the fair market value on March 1, 1913, and the sales price, and not merely the difference between the original purchase price and the amount realized on the sale, which would have been less.

This question of statutory construction is of importance, not only to the Government, but to a large number of taxpayers as well. The undersigned counsel is informed and believes that the Internal Revenue Department is continuing to compel payment of income taxes upon the principle which the Circuit Court of Appeals has unanimously held to be erroneous in the case at bar. That course necessarily involves unjust hardship to taxpayers; it complicates the administration of the tax laws, and it tends to create uncertainty and confusion. The Revenue Act in question was passed February 24, 1919, or nearly six years ago, and innumerable returns are affected.

There is now pending in this court, on appeal from the Court of Claims of the United States, the case of *Flannery* v. *United States*, No. 527, October Term, 1924, which has been set for hearing on January 5, 1925. The case at bar and the *Flannery* case involve different aspects of the above question concerning the proper construction of sections 202 (a) and 214 (a) of the Revenue

Act of 1918 as they relate to deductible losses arising out of the sale of property acquired prior to March 1, 1913.

In the *Flannery* case a sale was made by the taxpayer at more than the cost but at less than the market value on March 1, 1913. In the case at bar the sale was both at less than the cost and less than the market value on March 1, 1913.

As the case at bar and the *Flannery* case are thus closely related, and the latter has been set down for argument on January 5th, it is submitted that it would promote the due administration of the revenue laws for the court to hear and have before it the argument of both cases before declaring the proper meaning of these sections of the statute in question.

In view of the importance of the questions involved, the amounts depending upon their solution, and the fact that the *Flannery* case has been set for hearing on January 5, 1925, it is requested that this case be likewise advanced and set down for hearing on January 5, 1925, with and immediately after said *Flannery* case.

The Solicitor General in his petition for a writ of certiorari in the case at bar among other things said:

> "There is now pending in this Court on appeal from the United States Court of Claims the case of *United States* v. *Harriet R. Flannery, et al.*, No. 527 on the docket for the present term, in which another aspect of this same question is involved, namely, the sale by a taxpayer in the year 1919 of shares of stock owned by him on March 1, 1913, at less than the fair market price or value thereof on said date but at more than the anterior cost thereof. In the instant case there is involved the other aspect of the question, namely, sale by a

taxpayer in 1919 of shares of stock owned by him on March 1, 1913, at less than the fair market price or value thereof on said date as well as at less than the anterior cost thereof. Petitioner considers it desirable that this petition be granted in order that the instant case may be heard by this Court in connection with the *Flannery* case, so that there may be a complete adjudication by the Court of all phases of this important question."

Since the said *Flannery* case has been allotted full time for argument by the court, the undersigned counsel would deem it sufficient for the presentation of the present case if it were treated as on the summary docket for the purposes of time allowance.

December, 1924.

William D. Guthrie,
Of counsel for the respondent.

FILE COPY

Supreme Court of the United States

October Term, 1924, No. 733.

BLAKELY D. McCAUGHN, United States Collector of Internal Revenue,

Petitioner,

versus

CHARLES H. LUDINGTON,

Respondent.

Certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit.

BRIEF FOR RESPONDENT-TAXPAYER.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Of counsel for respondent-taxpayer.

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DEPARTMENT RULINGS CITED.

Supreme Court of the United States

OCTOBER TERM, 1924, No. 733.

BLAKELY D. McCAUGHN, Collector
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versus

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Respondent.

CERTIORARI TO A JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF ON BEHALF OF THE RESPONDENT-TAXPAYER.

The case comes before the court on certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit which reversed a judgment of the District Court for the Eastern District of Pennsylvania in favor of the defendant McCaughn as Collector of Internal Revenue, filed September 26, 1923 (record, p. 7). The plaintiff in the District Court was plaintiff-in-error in the Circuit Court of Appeals, and is respondent in this court. He will be hereinafter called plaintiff.

The sole point presented for consideration and decision is the interpretation and application of sections 202 (a) and 214 (a) (5) of the Revenue Act of 1918 (approved February 24, 1919, 40 Stat. 1060-1067) in respect of what losses are deductible for income tax purposes in the case of the sale or other disposition of property acquired before March 1, 1913. These sections read as follows:

> "Basis for determining gain or loss.
>
> "Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> "(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> "(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.
>
> "Deductions allowed.
>
> "Sec. 214. (a) That in computing net income there shall be allowed as deductions: . . .
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

Statement.

The plaintiff in the District Court sued to recover the sum of $3,094., which he had paid on November 16, 1922, under protest and duress in compliance with a demand of the defendant as Collector of Internal Revenue for an additional income tax for the year 1919 (pp. 2-4).

The demand for such additional tax arose by reason of the disallowance in part of a deduction claimed by plaintiff in his return for the year 1919 for losses sustained during the taxable year upon the sale of certain investments, namely, 490 shares of the first preferred stock of the United Gas and Electric Corporation and 60 shares of the six per cent. cumulative preferred stock of the American Cities Company (p. 3).

The 490 shares of United Gas and Electric Corporation stock were acquired by the plaintiff prior to March 1, 1913, at a cost of $28,000; the fair market value of said shares on March 1, 1913, was $32,445; the same were sold in 1919 for $3,693.81, and in the return for income tax he claimed as a deductible loss the sum of $28,751.19, which was the difference between the fair market value on March 1, 1913, and the price or amount received (p. 3).

The 60 shares of American Cities Company stock were acquired by the plaintiff prior to March 1, 1913, at a cost of $4,500; the fair market value of said shares on March 1, 1913, was $4,605; the same were sold in 1919 for $173.10, and in the return for income tax he claimed as a deductible loss the sum of $4,431.90, which was the difference between the fair market value on March 1, 1913, and the price or amount received (pp. 3-4).

The plaintiff's return for taxation for 1919 in these respects was in accordance with the official instructions to taxpayers printed on such returns, which, in turn, were in accordance with the Regulations of the Treasury Department then in force (Art. 1561, Reg. 45). Similar regulations had been in force since 1916. See appendix to this brief, pp. 6-19, 30.

The Commissioner of Internal Revenue, however, declined to recognize as the basis for ascertaining the loss sustained the fair market value as of March 1, 1913, but ruled that the basis must be the original cost, and grounded this ruling upon an amendment to Article 1561 of Regulations 45 (adopted July 28, 1921, after the decisions in the *Goodrich* and *Walsh* cases, *infra*), which amendment substituted cost for said market value and reads as follows (Appendix, pp. 41-2):

> "For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but more than its fair market value as of March 1, 1913." (T. D. 3206.)

The result was to substitute *cost* in place of the statutory basis of *market value as of March 1, 1913,* for ascertaining loss sustained by a taxpayer in respect of property purchased before that date whenever such cost was less than such value.

Accordingly, the Internal Revenue Commissioner reduced the deductible loss on said sales by the sum of $4,550, being the difference between the cost, viz. $32,500

and the said market value as of March 1, 1913, viz. $37,050; and this reduction increased correspondingly the taxable income of the plaintiff. The result was the additional tax of $3,094, which the plaintiff paid under duress and protest as aforesaid (pp. 2-4). A claim for refund was duly filed with the defendant Collector of Internal Revenue, but was rejected (p. 3), and the above entitled action was thereupon brought to recover the sum of $3,094 so paid as additional income tax. This action resulted in the District Court in a judgment in favor of the defendant, as aforesaid (p. 7), but the judgment was reversed on the merits by the Circuit Court of Appeals and a new trial ordered (pp. 11-16; 1 F. (2d) 689). The present certiorari brings the latter decision before this court for review.

The Circuit Court of Appeals, speaking by Circuit Judge Woolley, among other things said (pp. 14-15; 1 F. (2d), 692:

> "Reading the decisions of the Supreme Court in the Goodrich and Walsh cases as interpretations of the law only with reference to taxable gains—the subject of deductible losses was not touched—and believing that Congress is free to make its own definition of deductible losses, it follows that in construing the provision with reference to 'loss sustained' here in question, there is no constitutional limitation to be enforced and no constitutional doubt to be avoided, and hence no reason for restricted construction or for any construction which fails to give the words of the statute their plain meaning and import. United States *vs.* Standard Brewery Co., 251 U. S. 210, 217; MacKenzie *vs.* Hare, 239 U. S. 299, 308; Caminetti *vs.* United States, 242 U. S. 470, 485; Russell Motor Car Co. *vs.* United States, 261 U. S. 514, 519.

"The defendant urges upon the ground of consistency that as the Supreme Court has construed the word 'gain' to mean actual gain as distinguished from statutory gain, the word 'loss' should be construed to mean actual loss as distinguished from loss of the kind described in the words of the statute. Such identity of meaning in these provisions would, perhaps, be consistent if Congress had made it so. But Congress was free to make the provisions inconsistent if it chose. This is evidenced by the manner in which it has dealt with deductible losses in other income tax legislation. The income tax acts of the Civil War period, the revenue act of 1894 (held unconstitutional), the revenue act of 1913 allowed no deduction whatever for losses sustained from the sale of property of the kind involved in this case, although such losses might exceed the gains or profits derived from all other sources. The revenue act of 1916 allowed the deduction only of 'the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom.' The revenue act of 1918 was the first income tax law which allowed a deduction of loss however sustained, and it omitted the qualification of the word 'actually' in the phrase 'actually sustained' in the act of 1916 as well as the limitation therein 'to an amount not exceeding the profits arising therefrom.' If Congress was free to omit and to vary provisions for deductible losses in different revenue acts without relation to corresponding provisions for taxable gains, we think it had power to do the same thing in this act. Feeling that in this regard the power of Congress was not limited, we are constrained to construe the words 'loss sustained' in the section in question literally and to hold that they mean just what they say, even though, as in this instance, the loss sustained, ascertained in the manner prescribed by the statute, is greater in figures than it is in money and the effect of its

deduction from gross income is to decrease net income below its actual level. We are driven to this conclusion, startling as it may seem, because we cannot hold that Congress did not mean what it said and also because, the language of a statute being plain and its meaning clear and the statute itself being within the constitutional authority of the law-making body which passed it, our sole function is to enforce the law according to its terms. Lake Co. *vs.* Rollins, 130 U. S. 662, 670, 671; Caminetti *vs.* United States, 242 U. S. 470, 485."

It should be added that in *Flannery* v. *United States,* 4 Am. Fed. Tax Rep. 4030, decided May 19, 1924, the Court of Claims of the United States likewise upheld the contention of a taxpayer similarly situated and held that such was the plain meaning of Congress in the Act of 1918.* Answering the argument of the Government that only so-called *actual* losses were deductible, the court said:

> "Congress could have required that such a loss be shown, but it did otherwise. It carefully distinguished between 'property acquired before March 1, 1913' and property acquired on or after that date. As to the former, the price or value as of March 1, 1913, governs, and as to the latter, 'the cost thereof' governs. The first of these distinctions is wiped out if the cost prior to March 1 be required, and the second clause is useless if the original cost of the property must in every case be used in ascertaining the deductible loss."

In *Vance* v. *McLaughlin, Collector,* decided April 15, 1924, by the United States District Court, California, reported in the Prentice-Hall Federal Tax Service for 1924, ¶2804 B, District Judge Bourquin said:

> "The demurrer to the amended complaint is overruled.

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* The present respondent was granted leave by the Court of Claims in the Flannery case to file a brief as *Amicus Curiae* which was done by his counsel.

It is believed Congress meant what it plainly said, emphasized by the contrast between terms of pars. 1 and 2 of Sec. 202a of the Act.

And this decision is no wise inconsistent with the cases 255 U. S. They had to do with gains where there were none; this, with losses actually suffered.

For however values vary, there is no actual gain until sale and an amount realized in excess of cost. It is otherwise in the matter of losses. Any rescession in value once accrued and vested is an actual loss, and if the property is sold at recession, the loss appears and has been incurred, even though the sale be in excess of cost. That is, prior to March 1, 1913, for \$10; value that date \$20; sale in 1919 for \$15; the owner's loss is \$5, although the price received is \$5 in excess of cost."

With the exception of the decision of the District Judge in the case at bar, which has been reversed by the Circuit Court of Appeals, the courts have so far uniformly sustained the contention now submitted on behalf of the plaintiff-respondent.

POINTS.

I.

THE RULINGS IN *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* (255 U. S. 527 and 536) HAVE NO APPLICATION TO DEDUCTIBLE LOSSES.

In *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* (255 U. S. 527 and 536), the only question before the court for adjudication was as to the meaning of the words "gain derived" in section (2) (c) of the Revenue Act of 1916, and the court was not called upon in any aspect of the controversies then before it, to consider the provisions as to "losses sustained" contained in a different section, namely, section 5 of the same Act. The pertinent portions of the Act of 1916 are printed in the appendix to this brief, page 4.

In the *Goodrich* case the taxpayer had in 1912 acquired stock in a reorganized company of the value of $291,600; the value of this stock on March 1, 1913, was $148,635.50, and it was sold in 1916 for $269,346.25. The stock had, therefore, been sold by the taxpayer at a loss of $22,253.75 as compared with original cost. Nevertheless, the Collector assessed the tax on $120,710.75, being the difference between the market value as of March 1, 1913, viz., $148,635.50, and the amount for which it was sold in 1916, viz., $269,346.25.

In the *Walsh* case two transactions were involved. In one of these transactions, the taxpayer had during

the year 1909 purchased bonds for \$191,000 which he sold in 1916 for the same amount, and hence had made neither a gain nor a loss as compared with original cost. The market value of these bonds on March 1, 1913, however, was only \$151,845. The tax in dispute was assessed on the difference between this amount and the amount for which they were sold in 1916, viz., \$39,155. In the other transaction, the taxpayer had in 1902 and 1903 purchased bonds for \$231,300, which he sold in 1916 for \$276,150, or for \$44,850 more than original cost; but the market value of such bonds on March 1, 1913, was \$164,480. He was taxed upon the basis of the difference between such market value and the selling price, viz., \$111,670, as a taxable gain although his actual gain over cost had only been \$44,850.

It had then already been ruled by the Internal Revenue Bureau in this and all similar cases arising under the Revenue Act of 1916 that it was the intention of Congress to tax as "net income" of the taxpayer not simply the gain over cost, but a statutory or unrealized profit resulting from taking as a basis the market value as of March 1, 1913.

The argument on behalf of the plaintiffs-in-error in the *Goodrich* and *Walsh* cases was that the word "gain" in the Revenue Act of 1916 must necessarily be restricted to what was *"income"* within the true meaning of that term in the Sixteenth Amendment; that the authority of Congress to levy a tax under the Sixteenth Amendment was indisputably limited to "income", and that it could not fix any standard which would transmute into taxable income that which was in fact a loss and not income at

all. In other words, it was argued that as Congress could not constitutionally tax as income what was not in fact "income" and when there had in fact been no "income" because no actual gain as compared with original cost, the Act of 1916 must be construed so as to restrict the enactment within this constitutional limitation of power. Hence, it was insisted that Congress could not levy an income tax where no gain in fact existed as compared with original cost, because in final analysis such a tax would be unconstitutional in that it would be practically a burden upon and would have to be paid out of capital, and therefore, be a property tax as distinguished from an income tax, and void because not apportioned as required by the Constitution in respect of all direct taxes. *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 637.

The brief for the plaintiff-in-error in the *Goodrich* case contained the following statement on this point (at p. 63):

> "It is submitted that it is reasonably manifest that a construction of the Income Tax Law of 1916 which would practically result in levying a tax upon and measured by what is essentially diminished or reduced capital would be unconstitutional as being in substance and effect a direct tax payable solely in respect of capital or out of the proceeds of capital. At any rate, there are certainly 'grave doubts upon that score.' In such a case the rule in this court is to avoid a conclusion which might render a statute even of doubtful constitutionality (*United States v. Standard Brewery*, 251 U. S. 210, 220; *United States* v. *Jin Fuey Moy*, 241 U. S. 394, 401; *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366), and to adopt a construction which will avoid such doubts, if reason-

> ably permissible. Moreover, equally well-settled is the rule that any doubt as to the intent of a tax law will be resolved in favor of the taxpayer. *Gould* v. *Gould,* 245 U. S. 151; *Eidman* v. *Martinez,* 184 U. S. 578, 583-590."

This argument brought about a confession of error by the learned Solicitor General. It was contained in the brief which he then filed on behalf of the Government, and this brief expressly admitted that if the construction which the Department had uniformly given to the term "gain" in the Revenue Act of 1916, and under which the taxpayer had been forced to pay the tax in question as above stated, was a correct construction, "a serious constitutional question arises", and that after a careful study of the statute the Solicitor General had been "forced to the conclusion that the Commissioner has erroneously construed the statute." The Solicitor General added that the court should construe "gain" as used in the Act of 1916 so as to restrict its application to the amount by which the selling price exceeded the cost.

Reference to the opinion of this court in the *Goodrich* case (255 U. S., at p. 535) will show that its conclusion was based upon the constitutional limitation inherent in the term "income" as used in the Sixteenth Amendment. The court in effect declared that this term had been recently defined authoritatively by it, and it quoted such definition, viz.:

> "And the definition of 'income' approved by this court is: 'The *gain* derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.' *Eisner* v. *Macomber,* 252 U. S. 189, 207."

This limiting and controlling definition led logically to the conclusion of the court (at p. 535), namely: "It is *thus* very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor; and we therefore agree with the Solocitor General that since no gain was realized on this investment by the plaintiff-in-error, no tax should have been assessed against him."

Had there been no constitutional limitation inherent in the term "income" as used in the Sixteenth Amendment and no question as to the constitutional power of Congress to tax as income what was in substance and fact not income at all, the Solicitor General would not, of course, have confessed error, and the court would not, it is submitted, have limited the language of the statute and thereby restricted the application of the standard or measure of market value on March 1, 1913, as plainly fixed by Congress.

It should, therefore, be manifest that this restrictive construction was adopted by the court in order to avoid the constitutional point and that it was in accordance with the settled rule of the court thus to construe statutes so as to avoid constitutional doubts. *United States* v. *Delaware & Hudson Co.,* 213 U. S. 366, 407-8; *Texas* v. *E. Texas R .R. Co.,* 258 U. S. 204, 217; *Arkansas Gas Co.* v. *Railroad Comm.,* 261 U. S. 379, 383.

But no constitutional question whatever arises in connection with the subject of deductible losses, or requires or permits "a more restricted construction," to quote the phrasing of Mr. Justice Van Devanter in *Texas* v.

E. Texas R. R. Co., supra (258 U. S. at p. 217). No mention of losses is made in the Sixteenth Amendment, and there is no constitutional limitation upon the power of Congress in respect of the allowance or disallowance of losses. Congress may allow or disallow them at its will or in its discretion, and upon any basis or standard it sees fit to prescribe. The Revenue Act of 1913 allowed no such deductions as are now in question, and the subsequent Act of 1916 limited such allowable deductions. Taxable gain is a constitutional concept, namely, "income" which the taxpayer has "derived" within the meaning of those words in the Sixteenth Amendment (*Eisner* v. *Macomber,* 252 U. S. 189, 207), whilst deductible loss is a wholly statutory concept and presents and involves solely a question of the intent of Congress as expressed in the language it uses. *Brushaber* case, 240 U. S. 1; *Stanton* case, 240 U. S. 103; *Labelle Iron Works* case, 256 U. S. 377, and *Mente* v. *Eisner,* 266 Fed. 161.

It must follow, therefore, that as there is no constitutional limitation to be enforced and no constitutional doubt to be avoided in the case of deductible losses, and hence no reason for a "restricted construction," the ruling in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* does not apply to deductible losses, and the language used by Congress in respect of deductible losses must be interpreted, and given effect according to its plain meaning and import. Consequently, although the term "gain derived" in section 202 (a) of the Revenue Act of 1918 must necessarily be restricted in construction so as to bring its operation within the power of Congress and the constitutional limitation to actual "income . . .

derived,'' under the terms of the Sixteenth Amendment, the term ''loss sustained'' in that section must be given effect in accordance with the ordinary and plain import and meaning of the language used by Congress to express its intent unaffected and unlimited by any constitutional limitation.

II.

Fair market price or value as of March 1, 1913, is the basis fixed by the Revenue Act of 1918, not so-called ''actual loss.''

It is familiar knowledge that when Congress in 1913 came to draft income tax legislation in pursuance of the authority recently conferred upon it by the Sixteenth Article of Amendment to the Constitution of the United States, it concluded that it could not constitutionally tax as income any increment or increase in value of property which had accrued prior to March 1, 1913. This conclusion was based upon the theory that all increment or increase in value accrued up to that date ought to be treated as capital value and not income because prior to that date Congress had no power to levy an unapportioned tax upon income derived from property.

Congress, therefore, provided in the Revenue Act of 1913 that, for the year 1913, ''said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of

the specific exemptions and deductions herein provided for;" and hence, likewise, in each of the subsequent Income Tax Laws, the practice has been uniformly and consistently followed of treating increment or increase of value which had accrued before March 1, 1913, as not subject to taxation as income under the Sixteenth Amendment. In each of such Acts, therefore, only the increment or increase of value accruing after March 1, 1913, has been taxed as income.

Thus, the Revenue Act of 1913 did not tax, and was interpreted by the Internal Revenue Bureau as not taxing, increment or increase of value that had accrued before March 1, 1913; the Revenue Act of 1916 provided (sec. 2 (c)) that in respect of property acquired before March 1, 1913, "the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived;" the Revenue Act of 1918 (sec. 202 (a)) provided that "the basis shall be—in the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date", and the Revenue Act of 1921 provided substantially the same, although adding, as shown below (p. 47), qualifying provisions so that the taxpayer should not be taxable for any more than his gain over cost in the case of property acquired prior to March 1, 1913, in order to comply with the ruling of the court in *Goodrich* v. *Edwards, supra.*

The Revenue Acts after 1913 likewise made "the fair market price or value of such property as of March first, nineteen hundred and thirteen" the basis for ascertain-

ing "losses sustained" in the case of property acquired before said date (see Act of 1916, secs. 5, 6, 10 and 12 and sec. 202, Acts of 1918 and 1921), although as shown below (p. 47) the Act of 1921 added alternative provisions not found in the prior acts. In so doing, Congress undoubtedly conceived it to be fair and just that, if increment or increase of value accruing before March 1, 1913, was to be treated by Congress as capital value and as such not constitutionally taxable as income, it should likewise be treated as capital value for the purpose of ascertaining and determining deductible loss.

To illustrate in another form of expression: each statute provided, as to property acquired before March 1, 1913, that so-called "actual gain" should not be the standard or basis; for no matter how great the ultimate "actual gain" on a sale might be over the original cost, such "actual gain" was not to be taxable as income, but only the excess, if any, of the selling price over the fair market price or value on March 1, 1913. Consequently, although the gain or increase in value between the date of purchase and March 1, 1913, might as matter of fact be many times its original cost, no income tax was levied thereon.

So, likewise, in regard to losses: no matter how great might be the decrease in value prior to March 1, 1913, no deduction whatever was allowable therefor in the Revenue Acts of 1916, 1918 and 1921, but only for decreases accruing wholly after that date.

The losses deductible under the Act of 1913 (38 Stat. 114, 167) were limited to those in trade as a result of specified casualties, and no deduction was allowed in

respect of the sale or other disposition of property except in business or trade. *Mente* v. *Eisner,* 266 Fed. 161.

"Actual gain" and "actual loss" were, therefore, not adopted in any of these statutes as the general or uniform basis or standard for ascertaining taxable gain or determining deductible loss. For example, as to deductible losses, under each statute, the cost of property acquired prior to March 1, 1913, might be $100,000; its fair market value or price on March 1, 1913, might be only $50,000, or a decrease of fifty per cent. below cost, and its selling price $50,000. Yet, although demonstrably the taxpayer had sustained an actual capital loss of $50,000 as compared with the actual cost, not one dollar of such actual loss was deductible, even under the Revenue Act of 1921.

If, therefore, "*actual* loss" was not allowable as a deduction from taxable income, there was logically no reason why *actual cost* should be a limitation on any deductible decrease in value that accrued after March 1, 1913.

The scheme of the legislation was clearly that as the basis of cost prior to March 1, 1913, was being excluded from consideration in determining taxable income when such a basis would be favorable to the taxpayer, it should likewise and reciprocally be excluded when that basis in determining deductible loss would be favorable to the Government. And the reason for these provisions clearly was that Congress intended to treat as capital the fair market value or price of property as of that date as to both gains and losses, for only on that date had the Sixteenth Amendment become effective for prac-

tical purposes. The intent and purpose of Congress in that respect accordingly should be the controlling factor in interpreting and applying the provisions of all the Revenue Acts enacted by Congress since the ratification of the Sixteenth Amendment in 1913 except only where a restricted construction is necessary to avoid conflict with some constitutional limitation.

Furthermore, it should be appreciated that gains and losses are not and never have been treated as correlative or interdependent in federal income tax legislation. The allowance or disallowance of any deduction for losses has always been regarded and treated as essentially a matter of legislative concession or discretion irrespective and independent of the actual basis of taxation on income.

The Income Tax Acts of the Civil War period, that is from 1861 to 1867 inclusive, the Revenue Act of 1894 (held unconstitutional in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, and 158 *ib.* 601), and the Revenue Act of 1913, allowed no deduction whatever for losses sustained from the sale or other disposition of such property as is involved in the case now before this court, that is to say, "transactions entered into for profit but not connected with" the taxpayer's business or trade, although such losses might equal or exceed the gains or profits derived from all other sources. The Revenue Act of 1916, section 5, subdivision "Fifth", allowed the deduction only of "the losses *actually* sustained therein during the year to an amount not exceeding the profits arising therefrom." In fact, the Revenue Act of 1918 was the first income tax law which

ever allowed a deduction of loss however sustained, and it significantly omitted the limitation and qualification of the word "*actually*" in the phrase "actually sustained" in the Act of 1916 as well as the limitation therein "to an amount not exceeding the profits arising therefrom."

The above reasoning should be additionally conclusive if we bear in mind the fact that when the Revenue Act of 1918 was enacted decisions on this general subject had been rendered by the lower federal courts (*Mitchell Bros. Co.* v. *Doyle,* 225 Fed. 437, 439, 440, affirmed 235 Fed. 686, 691, and *Lynch* v. *Turrish,* 236 Fed. 653, 660, and affirmed by this court; see also *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, and *Lynch* v. *Turrish,* 247 U. S. 221), with the result that in the *Doyle* case the controlling principle was declared by this court to be "in order to determine whether there has been gain or loss, and the amount of the gain, if any, *we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration*" (247 U. S. at p. 185).

In T. D. 2740, promulgated by the Treasury Department, June 24, 1918, the foregoing decisions, among others, were listed, and therefrom were drawn certain conclusions, among them that of the controlling principle above expressed.

And in T. B. M. 73 (1 C. B. 35) the Tax Board explained this T. D. and these decisions to mean—

> "The principle underlying the Treasury Decision above referred to and the cases upon which it is based is that the gain or loss resulting from a sale of corporate stock is the difference between

> its value on March 1, 1913 (or, more accurately, Feb. 28, 1913), and the proceeds of the sale, . . ."

It is submitted, therefore, that the Government is in error in assuming that Congress intended that only "*actual losses*" should be deducted. Had Congress so intended, it would readily have found appropriate language, as it did in the revision embodied in the Revenue Act of 1921. The uniform general basis adopted by Congress plainly operated in most cases in favor of the Government by excluding as a deductible loss any decrease in value that had occurred prior to March 1, 1913, and in favor of the taxpayer only in those cases where values rose between purchase and March 1, 1913, and then fell again before the property was sold.

III.

The Revenue Act of 1918 expressly states that the basis of deductible loss shall be the fair market price or value as of March 1, 1913, and the plain meaning of this statutory language is controlling.

There can be no reasonable doubt that the language of section 202 (a) of the Revenue Act of 1918 above quoted (p. 2) and now before the court for interpretation and enforcement is perfectly plain and unambiguous, and that its ordinary import and meaning are obvious. It is general in application and permits of no such exception as is now sought to be incorporated. There is no

constitutional reason for a restricted construction, or for enforcing or implying any limitation upon the power of Congress. In the simplest and plainest form of expression that could possibly have been adopted it is provided "that in computing net income" certain losses "shall be allowed as deductions" (sec. 214 (a) (5)), and "that for the purpose of ascertaining the . . . loss sustained from the sale of . . . property *the basis shall be,* in the case of property acquired before March 1, 1913, *the fair market price or value of such property as of that date;* and, in the case of property acquired on or after that date, the *cost* thereof" (sec. 202 (a)). It would, indeed, be impossible to employ language more explicitly and unmistakably evidencing the discriminating intention of Congress to provide only for these two bases or standards with no exceptions, that is to say, on the one hand, the basis for *fair market price or value as of March 1, 1913,* as to property acquired before that date, and on the other hand, *cost* as to property acquired after that date.

Thus, the basis of market price or value on March 1, 1913, was to apply in the case of property acquired before that date, and the basis of cost in the case of property acquired after that date. There is nothing in the statute to warrant the slightest doubt as to the intention of Congress, in respect of deductible losses, or tending to create any ambiguity, or to suggest in the remotest degree that Congress did not mean exactly what it said, namely, *market value as of March 1, 1913,* in the one case, and *cost* in the other, and did not intend that this very plain and simple provision fixing the basis for ascertain-

ing all deductible losses should be enforced according to its letter. Since increases in value accrued prior to March 1, 1913, were treated, as they have been in all the Revenue Acts under the Sixteenth Amendment, as non-taxable because in substance and effect "capital value" (the term used by this court in the *Doyle* case, 247 U. S. at p. 185) existing as of that date, it was quite reasonable, consistent and logical to treat such accrued increase in value likewise as "capital value" for the purpose of computing deductible losses occurring or arising after that date.

It must be borne in mind—and this is repeated because it tends to clarify the discussion and avoid confusion of thought—that *taxable gain* and *deductible loss* in federal income tax legislation are not at all correlative subjects or in any sense interdependent, and that they have never been so regarded or treated by Congress. It has always allowed or disallowed deductions as it saw fit. As to taxable gains accruing after March 1, 1913, Congress was acting under the constitutional limitation on its power and discretion that only actual income could be taxed, and not theoretical gain, even though based upon the assumption that accrued increase or increment in value as of that date had become in practical effect part of the capital of the taxpayer; but, as we have seen, no such constitutional limitation exists or applies to the allowance or disallowance of deductible losses.

If the Revenue Act of 1918 had intended that "cost" should be the controlling factor in ascertaining loss in the case of property acquired before March 1, 1913, as the Government now contends, this section clearly would not

have declared the basis for ascertaining such loss to be the market price or value on March 1, 1913, and omit all reference to "cost" as a factor, when this very section explicitly makes "cost" the basis for such purpose with respect to property acquired on or after March 1, 1913. It will not do to say that Congress overlooked such an important aspect as cost prior to March 1, 1913; for it certainly had "cost" in mind as a basis in drafting this section, and must have realized the difference between the uniform basis of market value on March 1, 1913, as to both gains and losses, and an alternative basis of market value or cost whichever was respectively higher or lower. We are, therefore, led to the conclusion that the Revenue Act of 1918 in section 202 stated "the basis shall be" cost in the one case and market value in the other, because Congress meant that very thing and nothing else.

It must be equally manifest that section 202 was intended to be a complete and definitive formula. It is complete as to kind of property, applying whether the property be "real, personal or mixed." It is complete as to form of the transaction, applying whether the form be a "sale or other disposition". It is complete as to time of the transaction, applying whether the acquisition occurred before or after March 1, 1913. And it is complete as to establishment of a formula, dividing all such transactions into two groups at the point of time of March 1, 1913, and declaring that "the basis shall be" "the fair market price or value" *as of that date* as to one group, and as to the other group "cost".

Two other provisions of the Act of 1918 also persuasively show the intent of Congress as to the basis of March 1, 1913, and its ability to discriminate when it so intended.

Thus, (1) section 202 (b) provides as to the excess par or face value of new stock received on a reorganization as follows:

> "The amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

And (2) depletion and depreciation of improvements in the case of mines, wells, timber, etc., are required to be—

> "based upon cost including cost of developments not otherwise deducted: *provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken *in lieu of cost* up to that date:" (Secs. 214 (a) (10) and 234 (a) (9)).

Unquestionably, Congress manifested in each of these two provisions its intent to substitute market value in lieu of cost in respect of property acquired before March 1, 1913. As kindred provisions, they show that Congress intended the same thing in the earlier part of section 202 when it said "the basis shall be" market value as of that date. All these provisions, though varying slightly in words or arrangement, not only clearly evidence but express and carry out the same idea of taking value as of March 1, 1913, and making it "capital value" and as such the basis for determining taxable gain or deductible loss.

Yet, if the new departmental construction should now prevail, market value will not only *not* be "*the* basis" for determining deductible loss, but there will be many cases in which it will not be the basis or factor at all.

This court will not fail to note that the learned District Court found it necessary to interpolate the word "actual" in stating the intent of Congress to be that "only *actual* losses" should be deductible (p. 6). But the statute does not say so, and when Congress came later to express the very idea that the District Court thus implied as its prior intention, it deemed it necessary to use the elaborate phraseology of the Act of 1921 discussed at pp. 47-53, *infra.*

The learned District Court, it is submitted, made an inapposite choice of words in referring to "actual" gains and losses, and "fictitious or paper" profits and losses. The qualifying adjectives used by the District Court are not found in the Constitution or statutes, nor in either of the opinions of this court relied upon. It seems to have assumed that "actual" loss upon the sale of property could only be determined by a comparison of original or actual cost with sale price, and the opinion concludes with the declaration, quite *non sequitur,* that "the plaintiff therefore was not entitled to a deduction in excess of his actual loss . . ."

It is true that the loss of the taxpayer, determined in accordance with the provisions of the statute by comparing the value of the property as of March 1, 1913, with the sale price exceeded the difference between original cost and sale price. But it by no means follows that any part of this loss was not real or actual, or that any

part of it was "fictitious or paper"; just as it does not follow that market value as of March 1, 1913, was not in real substance and effect "capital value" as distinctly recognized by this court in the *Doyle* case, *supra*.

If a landowner constructed a building in 1905 at a cost of $50,000, and in 1913, owing to rising costs of material and labor, the building had a realizable market value of $100,000, and if this building were destroyed by fire arising through the negligence of a railroad company, who is there who would argue that the owner did not suffer a real and actual loss of $100,000 and was not entitled justly to recover on that basis? Who could reasonably assert that $50,000 of the loss was "fictitious or paper"? Surely, the courts would not hesitate to give judgment for $100,000 against the railroad company on the ground that that amount was the actual loss sustained. Nor would they hesitate to make an insurance company pay $100,000 if the building had been insured for that amount; nor would they consider under such circumstances as at all material that they were giving judgment in excess of the owner's *actual* loss.

Suppose, again, a farm had been purchased twenty or thirty or forty years before 1913 and had increased many times in value—of which innumerable instances in all States could readily be found and cited—would it be fair in determining loss in case of a sale below the value in 1913 to say that such value was "fictitious or paper" and that recourse must be had to original cost twenty, thirty, or forty years before?

A man who owned a building or securities worth $100,000 at their market value on March 1, 1913, would

clearly be in a position to sustain a loss of that amount—real and actual loss—regardless of what the property originally cost him, or whether he had acquired it by purchase or by gift.

Again: suppose a man bought 1,000 shares of stock in a company twenty years before March, 1913, for $10 a share and the company had so prospered that the stock in 1913 was quoted and readily salable on the market at $100 per share, and suppose thereafter, the earnings of the corporation fell off, cutting the dividends and the market value of the stock, say, in half, and he thereupon sold at $50 per share, would he not suffer an actual loss of $50 per share just as real and just as far from being "fictitious or paper" as if he had bought the stock in 1913 at $100 per share? Would he not realize only one-half of what he was actually worth or of his actual "capital value" in 1913?

A gain or loss, therefore, may be just as real when computed with reference to fair market price or value at a given date as when computed with reference to antecedent cost or value at another date.

One acquiring property by gift was regarded under the Revenue Acts of 1913, 1916 and 1918 as taking the property for the purpose of a subsequent computation of gain or loss at its *value* at the date of acquisition and not at its cost to the donor, or to the donee, which latter was nothing. The only reason for taking cost in those computations under the tax laws in which cost was made the basis, was that cost is generally the best evidence of value at the time of acquisition. The difference between value at the time of acquisition (evi-

denced by cost) and sale price may be gain or loss in some circumstances. The difference between value at some other date and sale price may be gain or loss under other circumstances. In either case it is the difference between *value* and sale price. Whether the *value* be taken at one time or at another does not make the gain or loss any more real or actual or any more "fictitious or paper."

Suppose a man carrying on business finds that the market value of his stock in trade drops 50 per cent during the year, so that the same goods represent only half as much on his closing inventory as they did on his opening inventory. Although he has not actually sold the goods, the Treasury Department permits him to deduct this difference between his opening and his closing inventory on the sound theory that he has realized a "capital value" loss to that extent. And this loss is real. If it were "fictitious or paper", would the Government, arguing as it does in the case at bar, permit its deduction? And if a loss representing the difference between opening and closing inventories be, for practical business and administrative purposes, sufficiently real to be deductible, why may not a loss representing the difference between March 1, 1913, market value and sale price? One is no more actual than the other.

The scheme of the income tax laws prior to that of 1921 was to take the value as at March 1, 1913, of property acquired before that date, rather than the value at acquisition or at any other date, for the basis in computing both gains and losses as being in accord with the best and latest adjudications.

Thus, this court said in *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185:

> "In order to determine *whether there has been gain or loss,* and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the *capital value* that existed at the *commencement of the period* under consideration.
>
> "This has been recognized from the beginning by the administrative officers of the Government." (Italics ours.)

The period under consideration referred to was not, therefore, the period of acquisition or ownership by the taxpayer but the period of the existence of the law under construction.

As pointed out above, there is no constitution limitation to be enforced and no restrictive construction required in the case of such deductions as Congress may or may not see fit to allow, and it follows that "it is not within the judicial province to give to the words used by Congress a narrower meaning than they are manifestly intended to bear" (*Trade Mark Cases,* 100 U. S. 82, 98, quoted with approval in *Butts* v. *Merchants Transportation Co.,* 230 U. S. 126, 136; see also *Hill* v. *Wallace,* 259 U. S. 44, 70). It is, of course, unnecessary to argue that questions of expediency or economic equivalency or other similar policies "are beyond judicial cognizance" (*Brushaber* v. *Union Pacific R. R. Co.,* 240 U. S. 1, 25). The will of Congress as evidenced by its plain and unambiguous language must be given effect, for it alone can determine what deductions are to be allowed. The courts cannot revise a taxing statute to adjust its impositions and allowances or to accord with some idea of economic

desirability or expediency or equivalency. And if there be any doubts, they must be resolved in favor of the taxpayer (*Gould* v. *Gould,* 245 U. S. 151).

Thus, Mr. Justice Sutherland, in delivering the opinion of the court in the recent case of *U. S.* v. *Merriam,* 263 U. S. 179, 187, stated and applied this principle as follows:

> "On behalf of the government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. Gould *v.* Gould, 245 U. S. 151, 153, 38 Sup. Ct. 53, 62 L. Ed. 211. The rule is stated by Lord Cairns in Partington *v.* Attorney General, L. R. 4 H. L. 100, 122:
>
> > 'I am not at all sure that in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'
>
> "And see Eidman *v.* Martinez, 184 U. S. 578, 583, 22 Sup. Ct. 515, 46 L. Ed. 697."

Moreover, courts cannot recoup the Government for what it may lose under the doctrine of the *Goodrich* case and its enforcement of a constitutional limitation. They cannot assume that Congress would have disallowed deductions on the basis of the market value as of March 1, 1913, if it had appreciated that it could not tax as income what was not in fact income. No court can say that Congress in grounding its whole scheme of income taxation upon the basis of market value on March 1, 1913, and treating *value* as of that date as "capital value", would not have allowed as deductible losses any decrease in such capital value after that date. If Congress recognized, as it did, the fairness and reasonableness or the constitutional necessity of treating market value as of March 1, 1913, as practically the capital value of property then owned by the taxpayer and increases in value then accrued as not taxable income, it was equally fair and reasonable to fix the same basis for the ascertainment and determination of deductible losses.

In a word, it is not within the legitimate power of the judiciary or its function or province to limit the plain meaning and import of the language used by Congress. As no constitutional limitation and no constitutional question are involved in the case of deductible losses, no limitation of or implication contrary to the plain letter of the statute is permissible or can be indulged or grafted or interpolated by the courts. *Commissioner of Immigration* v. *Gottlieb*, 265 U. S. 310, 313; *United States* v. *Standard Brewery*, 251 U. S. 210, 217; *Caminetti* v. *United States*, 242 U. S. 470, 485; *Mackenzie* v. *Hare*, 239

U. S. 299, 308; *United States* v. *Goldenberg,* 168 U. S. 95, 102-3; *Maxwell* v. *Moore,* 22 How. 185, 191.

Referring to this well-settled rule, the court at this term declared in the case of *Michaelson* v. *United States, etc., and Sandefur* v. *Canoe Creek Coal Co.,* 45 Sup. Ct. 18, 69 L. ed.—, Adv. Ops. 14, as follows:

> "If Congress had intended such an exception, it is fair to suppose that it would have said so affirmatively. The words of the act are plain and in terms inclusive of all classes of employment; and we find nothing in them which requires a resort to judicial construction. The reasoning of the court below really does not present a question of statutory construction, but rather an argument justifying the supposititious exception on the ground of necessity or of policy—a matter addressed to the legislative and not the judicial authority."

If it be argued on behalf of the Government that as the word "loss" is found in the Revenue Act of 1918 (although not in the Act of 1916) in immediate connection with and juxtaposition to the word "gain", and as "gain" has been construed so as to be restricted to "actual gain", the word "loss" should similarly be limited and restricted by reason of the doctrine of *noscitur a sociis,* the refutation of such an argument will, it is submitted, be sufficiently found in the recent case of *Russell Motor Car Co.* v. *United States,* 261 U. S. 514, 519, where Mr. Justice Sutherland, speaking for the court, used the following language:

> "Then it is said that inasmuch as the application of the word 'requisition' must be confined to private contracts, the other words associated with it must be likewise restricted by virtue of

the maxim *Noscitur a sociis*. That a word may be known by the company it keeps is, however, not an invariable rule, for the word may have a character of its own not to be submerged by its association. Rules of statutory construction are to be invoked as aids to the ascertainment of the meaning or application of words otherwise obsecure or doubtful. They have no place, as this Court has many times held, except in the domain of ambiguity. *Hamilton* v. *Rathbone,* 175 U. S. 414, 421; *United States* v. *Barnes,* 222 U. S. 513, 518-519. They may not be used to create but only to remove doubt. *Id.* Moreover, in cases of ambiguity the rule here relied upon is not exclusive. The problem may be submitted to all appropriate and reasonable tests, of which *Noscitur a sociis* is one. Here we have one word which it may be conceded applies only to private contracts, but the other three words standing alone, it likewise must be conceded, naturally apply to governmental contracts as well * * *.

"* * * *Noscitur a sociis* is a well established and useful rule of construction where words are of obscure or doubtful meaning; and then, but only then, its aid may be sought to remove the obscurity or doubt by reference to the associated words. *Virginia* v. *Tennessee,* 148 U. S. 503, 519; *Benson* v. *Chicago, etc. Ry. Co.,* 75 Minn. 163. But here the meaning of the words considered severally is not in doubt, and the rule is invoked not to remove an obscurity but to import one. There is nothing in the rule or in the statute which requires us to assimilate the words 'modify' and 'cancel' to the scope of the word 'requisition', simply because the latter has a necessarily narrower application. The meaning of the several words, standing apart, being perfectly plain, what should be done is to apply them distributively, *diverso intuitu,* giving to each its natural value and appropriate scope when read in connection with the object (any contract) which they are severally meant to control. Thus, the predicate 'requisi-

> tion' will be limited to private contracts, while the other words may be appropriately extended to include governmental contracts as well. An illustration is afforded by the Commerce Clause of the Constitution. The power to regulate interstate and foreign commerce is found in the same clause and conferred by the same words, but the scope of the power when applied to the former may be narrower than when applied to the latter. *Groves* v. *Slaughter*, 15 Pet. 449, 505."

As indicated above, and repetition is, perhaps, permissible for the sake of emphasis, it would be entirely erroneous to contend that taxable gain and deductible loss are corresponding and correlative concepts which have gone hand in hand through the Revenue Acts. The contrary is clearly true. All the Revenue Acts levying income taxes from that of 1913 to date have taxed as income any gain, whether or not the gain arose from a trade or business or any transaction entered into for profit. Thus, for example, a gain derived from the sale by a manufacturer of shares of stock, or a merchant of his residence, or a lawyer of his pleasure automobile, has always been taxed as income irrespective of his business losses. An entirely different rule has, however, always prevailed as to deductible loss. Under the Revenue Act of 1913, the loss had to be "incurred in trade", and, therefore, a loss sustained by the manufacturer on a sale of shares of stock was not deductible under that Act (*Mente* v. *Eisner*, 266 Fed. 161). Under the Acts of 1916 and 1917 losses incurred in a transaction if *entered into for profit* but not connected with the trade or business of the taxpayer could be deducted only to an amount not exceeding the profits arising from such transactions. Gains

in illegal transactions have always been held by the Treasury Department to be taxable, whilst the Department has never permitted the deduction of losses in similar transactions. And under none of the Revenue Acts has a taxpayer been allowed to deduct a loss sustained through the sale of a residence or a pleasure automobile (Art. 141, Reg. 45; O-780, 1 C. B., p. 117). In a word, while every gain has been uniformly taxed, not every loss, even though indisputably "actual", has been allowed or deducted.

IV.

The language of the Revenue Act of 1918 is more definite and certain than the language of the Revenue Act of 1916 and more favorable to the taxpayer.

The pertinent provisions of the Revenue Acts of 1916 and 1918 are respectively as follows:

Revenue Act of 1916	Revenue Act of 1918
"For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the	"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be— (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

amount of such gain derived." (Sec. 2 (c).)

"That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;" (Sec. 5 (a)).

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203." (Sec. 202 (a).)

"That in computing net income there shall be allowed as deductions:—

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insur-

company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained." (Sec. 10.)

ance or otherwise;" (Sec. 214 (a)).

"That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:—

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;" (Sec. 234 (a)).

From the start the construction placed upon the language of the Revenue Act of 1916 by the Treasury Department was that the basis of value as of March 1, 1913, applied exclusively in the case of property acquired before March 1, 1913, and that cost applied exclusively in the case of property acquired on or after that date (see appendix, pp. 24-34). The Revenue Act of 1918 in unmistakable language adopted and embodied this practical, administrative construction.

The 1918 Act was more liberal to the taxpayer in the matter of deductions for losses than the Act of 1916, as it allowed without limit losses in transactions entered into for profit, though not connected with the trade or business and though not arising through fire, storm, shipwreck, etc.

It has, however, been rather subtly argued that the sections providing for ascertaining gain or loss apply only to ascertaining the *amount*, after the *fact* of gain or loss is otherwise once determined. In the 1916 Act the provisions begin "for the purpose of ascertaining the $\left\{\begin{matrix}\text{gain derived}\\ \text{loss sustained}\end{matrix}\right\}$" and end with the direction that "the

fair market price or value of such property shall be the basis for determining the *amount of* $\left\{\begin{array}{l}\text{such gain derived}\\ \text{such loss sustained}\end{array}\right\}$".
Even if this reference to *amount* might possibly and subtly be construed as a limitation upon what was to be ascertained in this manner, nevertheless in the 1918 Act the term *amount* disappeared, and the language employed was "that for the purpose of ascertaining the gain derived or loss sustained . . . the basis shall be . . . the fair market price or value of such property," etc.

Moreover, the Revenue Act of 1916 only permitted the deduction of losses "*actually* sustained", while the Revenue Act of 1918 now before this court for construction and application allows the deduction of "losses sustained", the word "actually" having been eliminated.

V.

Effect of uniform departmental construction and of substantial re-enactment in the Revenue Act of 1918 of the provision as to deductible losses contained in the Act of 1916.

The Treasury Department from 1916 to 1921 uniformly and consistently interpreted the Revenue Acts of 1916 and 1918 in every case as prescribing and fixing the basis of market value as of March 1, 1913, and not cost for ascertaining the amount of deductible loss. Pertinent regulations and decisions of the Department are printed in the appendix filed with the present brief.

This long practical interpretation by the experts of the Treasury Department was clearly in accord with the plain import and meaning of the language employed by Congress. Indeed, it seems never to have occurred to these experts that any doubt was possible until the *Goodrich* case showed that Congress could not tax as income what was in fact and truth not income at all within the true meaning of the term as used in the Sixteenth Amendment, and that, therefore, a restricted construction was necessary as to taxable gain.

The practical interpretation thus applied by the Treasury Department was uniformly enforced for six years, and taxpayers were instructed to make out their returns from 1916 to 1921 inclusive upon that basis. Innumerable have been the instances of reliance upon such practical departmental or administrative interpretation and consequent adjustment of taxpayers' affairs. When the plaintiff in the case at bar filled out his return for the year 1919 he relied, and surely was entitled to rely, not only upon the language of the statute, but upon the rulings of the Department and the official forms it furnished. It was not in fact until long after the filing of this return that there came about the complete change of mind by the Department and the setting aside of its long enforced regulations; and it was only pursuant to such change that the levy of the additional tax on plaintiff was made in November, 1922.

Furthermore, in Article 141 of Regulations 45 as originally promulgated under the Revenue Act of 1918, it was provided that, when loss through casualty was

claimed, the amount deductible in the case of property acquired before March 1, 1913, should be the difference between its fair market value as of that date and the salvage value thereof, taking into account the amount set aside for depreciation, as well as insurance received on account of the loss.

In T. D. 3206, promulgated July 28, 1921, consequent upon the decisions in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster,* this portion of Article 141 was changed so as to provide that when the fair market value as of March 1, 1913, was higher than cost, the deductible loss should be the difference between cost and the salvage value, and that no loss should be recognized where the salvage value was less than the cost but more than the depreciated value of the property as of March 1, 1913.

By the Revenue Act of 1921, however, this latter standard was repudiated by Congress, and it was specifically provided as to losses by casualty as follows:

> "In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Secs. 214 (a) (6) and 234 (a) (4)).

The court will note that the language thus used is exactly the same as that contained in section 202 (a) of the Act of 1918 under review in this case, and as to which we have the two above conflicting constructions by the Department, first by Article 141 of Regulations 45, and secondly by T. D. 3206; and it was adopted according to the Conference report "to remove all doubt" as to what Congress intended (*post,* p. 51).

This court has again and again declared that such a departmental construction is entitled to great respect and ought not to be disregarded without cogent and persuasive reasons, such as the constitutional limitations which operated in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster*. See *Logan* v. *Davis,* 233 U. S. 613, 627; *Kern River Co.* v. *United States,* 257 U. S. 147, 154; *LaRoque* v. *United States,* 239 U. S. 62, 64. This rule is so familiar that it is unnecessary to quote from the opinions.

Moreover, it is a real hardship upon taxpayers to be compelled years after paying income taxes in conformity with the rules prescribed by the Department to be mulcted in additional taxes because of a subsequent departmental change in the interpretation of the applicable statute. In *Rock Spring Co.* v. *W. A. Gaines & Co.,* 246 U. S., at p. 320, this court quoted with approval the following statement by Circuit Judge Sanborn in *Layton Pure Food Co.* v. *Church & D. Co.,* 182 Fed. 35, 39:

> "Uniformity and certainty in rules of property are often more important and desirable than technical correctness."

But equally important, if not controlling, is the reenactment in the Revenue Act of 1918 of the provisions of the Act of 1916 substantially to the same effect in regard to the allowance of deductible losses.

In an opinion of the Attorney General under date of August 23, 1922 (T. D. 3393, 33 Op. Atty. Gen. 291), printed in full in the appendix to this brief (at p. 59), it was said:

> "No substantial changes having been made in the corresponding sections of the two Acts [1916

> and 1918], it is assumed that both Acts were intended by Congress to have the same construction, and the same basis should be employed in arriving at taxable gains and deductible losses upon the sale or other disposition of property."

This re-enactment in the Revenue Act of 1918 of the provision now in question in substantially the same terms as it appeared in the Revenue Act of 1916, particularly in view of this opinion of the Attorney General, was, it is submitted, an adoption by Congress of the practical construction of the prior Revenue Act by the executive officers of the Government.

United States v. *Falk,* 204 U. S. 143, 152; *Copper Queen Consolidated Mining Co.* v. *Arizona Board,* 206 U. S. 474, 479; *United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337, 339; *Latimer* v. *United States,* 223 U. S. 501, 504; *National Lead Co.* v. *United States,* 252 U. S. 140, 146-7; *Heald* v. *District of Columbia,* 254 U. S. 20, 23.

Moreover, the construction put by the Government upon the Revenue Act of 1918 is based upon no authority other than the Treasury Department's regulation and the opinion of the Attorney General mentioned above. In that opinion the Attorney General among other things says (appendix, p. 63):

> "Taxable gain having been thus construed by the Supreme Court, it follows that 'deductible loss' should have the same construction, the provisions relating to losses being practically identical with those relating to gain. In making the concession as to taxable gains, the Solicitor General, in his brief in the Goodrich cases, cited above, made the further concession that a loss on the complete transaction must have been sustained

in order to make it a deductible loss, and that only the loss occurring subsequent to March 1, 1913, should be allowed as a deduction. . . ."

"Replying specifically to the inquiry, I am of the opinion that where property acquired prior to March 1, 1913, is sold or disposed of thereafter—

"(a) Taxable gain resulted if the selling price was higher than the value on March 1, 1913, and if that value was higher than the cost thereof, to the extent that the selling price exceeded the value on March 1, 1913;

(b) Taxable gain resulted if the selling price was greater than the cost and if the cost was greater than the value on March 1, 1913, to the extent that the selling price exceeded the cost of the property sold or disposed of;

(c) No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof;

(d) An allowable loss resulted if the selling price was less than the value on March 1, 1913, and if that value was less than the cost to the extent of the difference between the value on March 1, 1913, and the selling price;

(e) No taxable gain or deductible loss resulted if the selling price was less than the value thereof on March 1, 1913, but greater than the cost; or

(f) An allowable loss resulted if the selling price was less than the cost and if the cost was less than the value on March 1, 1913, to the extent that the cost of the property disposed of exceeded the selling price thereof."

The Attorney General thus declares that "deductible loss" should have the *same* construction, but he then proceeds to give it a diametrically opposite construction. If we are to interpolate the words "or cost, whichever is higher" with respect to the basis for determining gains,

we should interpolate the *same* words "whichever is higher" with respect to the basis for determining losses —not the exactly opposite words "whichever is lower" which the construction of the learned Attorney General in effect requires.

In the Revenue Act of 1924 the Congress clearly recognized the incongruity we have mentioned of ascertaining "gains" on the basis of whichever is higher, and "losses" on the basis of whichever is lower, and corrected the law accordingly, the Act of 1924 providing:

> "The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4) or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, *whichever is greater*" (sec. 204 (b)).

The learned Attorney General also said:

> "The Solicitor General . . . made the further *concession* that a loss on the complete transaction must have been sustained in order to make it a deductible loss."

But the Solicitor General could not *concede* a point that was not at issue in the case nor urged by his adversary! Statutory construction by "concession" of the Solicitor General is something quite novel in our jurisprudence. And this court apparently so regarded it, as is indicated by the fact that although it approved the Solicitor General's concession with respect to gains, it wholly ignored his uncalled for, gratuitous and obiter "concession" with respect to losses.

In the District Court in the *Goodrich* case, the Government insistently urged that since the act *was* being construed literally with respect to losses,—that is to say upon the basis of market value as of March 1, 1913,—it should likewise be literally construed with respect to gains. Expecting a similar contention in this court, the counsel for the taxpayer refuted the argument by pointing out that, with respect to losses, Congress was not subject to any restrictions and a literal construction could not, therefore, be objected to, but that, with respect to gains, the Constitution limited the power of Congress and the statute must be restricted to conform to the Constitution.

What the taxpayer's counsel had to say in the *Goodrich* case with respect to losses was as follows (brief, p. 62):

> "The fact that the date of March first, 1913, is adopted in the Act of 1916 likewise for the purpose of determining a loss, that is, 'the basis for determining the amount of such loss sustained', is immaterial, because the allowance of the deduction of losses actually sustained is wholly a statutory concession, and Congress might, as it did in the Income Tax Act of 1913, c. 16, 38 Stat. 166, limit the losses allowable and exclude altogether as a deduction capital losses not sustained in carrying on a business or trade."

This language clearly left no room for inferring a *concession* of anything except the proposition that the rules with respect to gains and losses were entirely unrelated. In other words, there was no basis whatever for a *concession* by the Solicitor General with respect to losses unless it were the concession that the statute in respect of losses must be literally construed and not restricted.

VI.

THE PROVISIONS OF THE REVENUE ACT OF 1921 ALSO SUPPORT PLAINTIFF'S CONTENTIONS.

In November, 1921, the Revenue Act was amended by Congress in respect of income taxes so as among other things to provide that the basis for ascertaining both gain and loss in respect of property acquired before March 1, 1913, should thereafter in certain alternative cases be *cost* instead of *market value;* but the basis of *market value as of that date* was nevertheless retained as the general rule or basis in respect of all other cases of loss, including loss by casualty (Revenue Act of November 23, 1921, section 202 (a); 42 Stat. 227, 229).

For convenience of comparison, the provisions contained in the Revenue Acts of 1918 and 1921 are printed below in parallel columns so that the court may more readily perceive how much must be added by construction to the Act of 1918 in order to make it read and operate as now contended for by the Government. The Revenue Acts of 1916 and 1918 are in substance and effect the same, although in the Act of 1916 the respective provisions as to ascertaining gains and losses were in separate sections and deductible losses were limited "to an amount not exceeding the profits arising therefrom."

Revenue Act of 1918.	*Revenue Act of 1921.*
"Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition	"Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property,

of property, real, personal or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with sec. 203."

real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property . . .

"(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); [i. e., cost] but—

"(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

"(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

"(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income."

It would surely be unreasonable and contrary to settled canons of interpretation to conclude that the distinctive and discriminating additions made in 1921, upon the recommendation of the Treasury Department as the public records show, wrought no change in the law as it existed prior to that date. To regard the amended law as accomplishing no change whatever is a clear strain on the common sense of the new provisions and supplemental language. On the contrary, such additional and amendatory language should be regarded as evidencing, and the reasonable presumption is, that in the judgment of Congress the Revenue Acts of 1916 and 1918 did not embrace the specific provision which the amended regulations grafted upon them and which the Act of 1921 expressly supplied.

Quite an analogous situation came before this court for adjudication in the case of *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 606. The opinion of the court referred to the fact that the Treasury Department had not attempted for two years to collect any tax on income of the character then involved, that the Deputy Commissioner of Internal Revenue had ruled that the tax could not be levied, and that this ruling had been later changed by the Commissioner of Internal Revenue. Similarly in the case at bar under the Revenue Acts of 1916 and 1918, the Treasury Department for practically six years had directed taxpayers to deduct losses on the sole basis of the market value as of March 1, 1913; such were the instructions in the official forms, regulations and rulings, and the Commissioner of Internal Revenue later, in July, 1921, had changed the rule by amending Art. 1561 of Reg. 45.

Mr. Chief Justice Taft, speaking for the court, among other things, said:

> "This [the change of ruling by the Commissioner of Internal Revenue] seems to us to graft something on the statute that is not there. It is an amendment, and not a construction, and such an amendment was made in subsequent income tax laws, as we shall see. . . . It is obvious that, in the acts subsequent to that of 1913, Congress sought to make specific provision for the *casus omissus* in the earlier act. . . . In the later act, such property was expressly included. This was thought by the court to show at least a legislative doubt whether the earlier act included such property. This court said (p. 264) that it would have been easy for Congress to express a purpose to tax such property, but it had not done so. . . . In the next act, it did so. We cannot supply the omission in the earlier act."

In *Harriman* v. *Interstate Commerce Com.*, 211 U. S. 407, 422, Mr. Justice Holmes delivering the opinion of this court, said

> "The passage of the amendment indicates that without it the power would be wanting."

In *United States* v. *Bashaw*, 50 Fed. Rep. 749, 753-4,* the Circuit Court of Appeals for the Eighth Circuit among other things said:

> "The natural presumption is that the phraseology of the statute was changed in order to change its meaning. The very fact that the prior act is amended demonstrates the intent to change the pre-existing law, and the presumption must be that it was intended to change the statute in all the particulars touching which we find a material change in the language of the act."

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* Reversed upon another point.

See also, for persuasive instances of the application of this settled rule, *Rich* v. *Keyser,* 54 Pa. St. 86, 89; *Brown* v. *The German-American Title & Trust Co.,* 174 Pa. St. 443, 459; *State Highway Route No. 72,* 265 Pa. St. 369, 373; *United States* v. *A. J. Woodruff & Co.* (C. C. A. 2nd Cir.), 175 Fed. 776, 777; *Dailey* v. *Pugh* (Ind. App.), 131 N. E. 836; *State* v. *Beal,* 185 Ind. 192, and *Board of Education* v. *Boehm,* 102 Ohio St. 292.

The New York Court of Appeals had a similar question before it in the *Matter of Miller,* 110 N. Y. 216, 222, and discussed this rule of statutory construction. After pointing out that the so-called reason and equity of a statute could not control its plain language, although it might seem to the court that the legislature would have provided otherwise had its intention been directed to the effect then before the court, the court added:

> "Moreover, the fact that such provision was made by the statute of 1887 (Chap. 713), and the Act of 1885 amended accordingly, must be regarded as a legislative declaration that the law did not, as originally passed, embrace the provisions which the latter act supplies."

It appears from the Conference Report (p. 25) that the purpose of the 1921 provision discussed at p. 41, *supra,* was

> "to remove a doubt in existing law as to whether the basis of such a loss should be the value of the property on March 1, 1913, or the cost thereof."

Article 141 of Regulations 62, as promulgated under the Revenue Act of 1921, construes and contrasts this

provision with the other kindred terms of the Act of 1921 as follows:

> "LOSSES. Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by non-resident aliens) if (a) incurred in a taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions.
>
> "*In the case of the sale of assets* the loss will be the difference between the cost thereof, less depreciation sustained and allowable as a deduction in computing net income, and the price at which sold or disposed of. See Article 1561. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation) and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913, or for more than cost but less than the fair market value as of March 1, 1913. See Section 202 of the statute and articles 39-46 and 1561.
>
> "*When loss is claimed through the destruction* of property by fire, flood, or other casualty, the amount deductible will be the difference between the cost of the property, less proper adjustment for depreciation, and the salvage value thereof. In the case of property acquired before March 1, 1913, however, the deductible loss is the difference between the fair market value of the property as of that date, less proper adjustment for depreciation, and the salvage value thereof. In any event the loss should be reduced by the amount of any

insurance or other compensation received. See articles 49 and 261-263.

"*A loss on the sale of residential property* is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom."

Any suggestion that the language of section 202 of the Revenue Act of 1921 was intended to be interpretative rather than amendatory seems to be clearly negatived by the failure of the Act to indicate any such purpose. If Congress had intended the Act of 1921 to control with respect to the construction of the Act of 1918, it would certainly have so declared. Thus, when it had any such intent in mind, it knew how to indicate it, as is demonstrated in section 1331 of the same Act of 1921, where it laid down the rule for consolidation of returns under the 1917 law, as follows:

"Sec. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

. . . .

(c) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917."

It would, of course, have been as easy for Congress to have done the same with respect to section 202 of the Act of 1918, had it then had any such intent, and its silence reasonably indicates a contrary purpose.

Conclusion.

It is, therefore, submitted that the plain statutory standard of "fair market price or value of property" as of March 1, 1913, is the proper basis for determining deductible loss under the Revenue Act of 1918 as to property acquired before that date; and that consequently the judgment of the Circuit Court of Appeals was correct and should be affirmed.

New York, January 5, 1925.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Of counsel for respondent-taxpayer.

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Supreme Court of the United States

October Term, 1924, No. 733.

BLAKELY D. McCAUGHN, United States Collector of Internal Revenue,

Petitioner,

versus

CHARLES H. LUDINGTON,

Respondent.

Certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit.

APPENDIX TO BRIEF FOR RESPONDENT-TAXPAYER.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Of counsel for respondent-taxpayer.

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Supreme Court of the United States

October Term, 1924, No. 733.

Blakely D. McCaughn, Collector of Internal Revenue,

Petitioner,

versus

Charles H. Ludington,

Respondent.

APPENDIX TO BRIEF ON BEHALF OF RESPONDENT-TAXPAYER.

This appendix to the brief on behalf of the respondent-taxpayer presents in convenient form the pertinent provisions of the Revenue Acts of 1916, 1918 and 1921, respectively, relating to the determination of gains and losses derived from sales or dealings in property, and also the material regulations of the Treasury Department for the administration of such provisions. The Revenue Acts of 1913 and 1917 are not included, because the former contained no provision for the determination of gain or loss on the sale of property acquired before March 1, 1913, and the latter did not modify the provisions of the Revenue Act of 1916 relating to such determination.

From the date of the enactment of the Revenue Act of 1916 on September 8, 1916, and from the date of the enactment of the Revenue Act of 1918 on February 24, 1919, until the decision of the Supreme Court in *Goodrich* v. *Edwards* (255 U. S. 527), on March 28, 1921, the uniform construction placed upon both of these Revenue Acts by the Treasury Department was that now asserted by the respondent-taxpayer and adjudged as correct by the Circuit Court of Appeals for the Third Circuit in the case at bar and by the Court of Claims in *Flannery* v. *United States.* But after the decision in *Goodrich* v. *Edwards,* and after the enactment of the Revenue Act of 1921 on November 23, 1921, until the present time the construction placed upon all three Acts by the Treasury Department has been that now advanced on behalf of the Government. It will be noted, therefore, that while the Revenue Act of 1916 was in force, and for most of the time that the Revenue Act of 1918 was in force, the departmental construction was one way, but that for the last few months that the Revenue Act of 1918 was in force, and since the Revenue Act of 1921 has been in force, the departmental construction has been directly to the contrary.

The immediate cause of this change of practical construction and application with respect to losses was the decision in *Goodrich* v. *Edwards.* This extension of the principle of that decision was at once challenged as erroneous, and the Treasury Department thereupon obtained an opinion of the Attorney General, dated August 23, 1922. This opinion presumably contains the reasons

for the present attitude of the Treasury Department, and a copy thereof is printed in this appendix at pp. 59-66.

The Respondent-Taxpayer is not now concerned with the construction of the Revenue Act of 1921 adopted by the Treasury Department. Its provisions are included simply for the purpose of comparison, in order to emphasize, by way of illustration, how they strikingly differ from the provisions of the Revenue Act of 1918.

Many informal rulings of the Internal Revenue Bureau, readily obtainable, were uniformly in accord with the formal regulations in force at the time, which regulations are herein printed at pp. 6-21, 24-46, 50-59.

STATUTES AND REGULATIONS.

A.

Revenue Act of 1916.

I. Statute

(1) As to gains by individuals:

"That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from . . . sales, or dealings in property, whether real or personal, . . ." (Sec. 2 (a).)

"For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (Sec. 2 (c).)

(2) As to losses by individuals:

"For the purpose of the tax there shall be allowed as deductions— . . .

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property, as of March first nineteen hundred and thirteen shall be the basis for determining the amount of such loss sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom." (Sec. 5 (a).)

(3) As to depreciation and depletion in the case of individuals:

"For the purpose of the tax there shall be allowed as deductions— . . .

Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury; *Provided,* That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made." (Sec. 5 (a).)

(4) As to gains and losses, including depreciation and depletion, in the case of corporations:

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of

March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained." (Sec. 10 (a).)

"In the case of a corporation . . . such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources— . . .

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided,* That when the allowance authorized in (a) and (b) shall equal the capital originally invested or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; . . ." (Sec. 12 (a).)

II. Regulations

(1) As to gains and losses:

1. "*Gifts.*—The fair market price or value of stock acquired by gift subsequent to March 1, 1913, is the basis for computing gain derived or loss sustained by the sale thereof. If acquired by gift prior to March 1, 1913, the fair market price or value as of that date is the basis for computation." (Reg. 33 (rev.), ¶41.)

2. "*Profit from the sale of stock.*—When stock is sold from lots purchased at different times and at different prices and the identity of the lots can not be determined as to dates of purchase, the stock sold shall be charged against the earliest purchases of such stock. The difference between cost and amount realized on the sale will be the profit to be accounted for as income if the purchase was on or after March 1, 1913. Profit derived from the sale of stock purchased prior to March 1, 1913, is the difference between the fair market price or value as of that date and the selling price." (Reg. 33 (rev.), ¶60.)

3. "In cases where securities or other assets, real, personal, or mixed, acquired prior to March 1, 1913, are disposed of during the year, the gain or loss thereon will be based upon the difference between the price at which disposed of and the fair market price or value of such assets as of March 1, 1913, or the difference between the price at which disposed of and the *cost* if acquired subsequent to that date." (Reg. 33 (rev.), ¶352.)

4. "*Art. 94. Income from damages recovered.*—When a corporation as a result of suit or otherwise secures payment for damages which it may have sustained, and the amount of such payment is in excess of an amount necessary to make good the damage or damaged property, the amount of such excess shall be considered and returned as income for the year in which received. If the entire or an estimated amount of the damage shall have been previously charged off and deducted from gross income, then the amount recovered shall be returned as income.

If the amount recovered is less than the damage sustained or less than an amount necessary to make good the damage, the difference between the actual amount of damage sustained and the amount recovered will be deductible as a loss." (Reg. 33 (rev.), ¶357.)

5. *"Art. 101. Income from sale of capital assets.*—If a corporation sells its capital assets in whole or in part, it will include in its gross income for the year in which the sale was made an amount equivalent to the excess of the sales price over the fair market price or value of such assets, as of March 1, 1913, if acquired prior to that date, or over cost if acquired subsequent to that date." (Reg. 33 (rev.), ¶366.)

6. *"Art. 109. Sale of patents.*—A corporation disposing of patents by sale, should determine the profit or loss arising therefrom, by computing the difference between the selling price and the cost, or value as of March 1, 1913, if acquired before that date. The apparent profit or loss should be increased or decreased, as the case may be, by the amounts deducted since March 1, 1913, as a return of capital invested in such patents." (Reg. 33 (rev.), ¶379.)

7. *"Art. 111. Exchange of property for stock.*—In cases wherein property was taken over in exchange for the capital stock of a corporation at a par value in excess of the fair market value of the property, and such property should be later sold, it will be necessary to ascertain as nearly as possible the fair market value of the property at the time it was taken over or as of March 1, 1913, if acquired before that date, and any excess over this ascertained fair market value at which the property is sold will be held to be profit or income to the corporation for the year in which the sale was made." (Reg. 33 (rev.), ¶381.)

8. *"Art. 112. Excess value.*—Similar action may be taken in cases wherein corporations acquire property prior to March 1, 1913, for a mere nominal sum and which had, as of March 1, 1913, a value greatly in excess of such nominal sum. A careful estimate of the fair market value of such property as of March 1, 1913, may be made and set up as the capital invested in the property, and if such property is thereafter disposed of at a

price in excess of such fair market value, the amount so in excess will be treated as income to be accounted for in preparing the return of annual net income of the year in which the property is sold. The value of the property fixed in the manner and for the purpose hereinbefore indicated will be subject to the approval of the Commissioner of Internal Revenue." (Reg. 33 (rev.), ¶382.)

9. "*Art. 116. Sale of capital assets.*—Section 10 of this title provides that for the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired prior to March 1, 1913, the fair market price or value of such property, as of that date, shall be the basis for determining the amount of such gain derived.

This provision contemplates that all such gain realized and so ascertained, in cash or its equivalent, upon the sale or disposition of capital assets, shall be returned as gross income. In the case of property acquired subsequent to March 1, 1913, and later sold or disposed of, the difference between the cost and the selling price will be returned as income for the year in which the sale is made." (Reg. 33 (rev.), ¶¶ 387, 388.)

10. "*Sales on instalment plan.*—In cases wherein the property is sold on the installment plan, title passing at the time of sale, the gain to be returned as income for the year in which the sale was made will be the excess of the contract price over the fair market price or value as of March 1, 1913, if the property was acquired prior to that date, or of the contract price over the cost, if acquired subsequent to March 1, 1913. If the buyer forfeits his contract and fails to meet any of the payments contracted to be made, the selling corporation may deduct from its gross income as a loss, such proportion of the defaulted payments as was previously returned as gross income. (T. D. 2137.)" (Reg. 33 (rev.), ¶389.)

11. "In the case of real estate corporations, which purchase, or shall have purchased, a tract of land with a view to dividing it into lots or parcels of ground to be sold as such, the entire value, as of March 1, 1913, or cost, if acquired subsequent to that date, shall be equitably apportioned to the several lots or parcels, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made.

Real estate subdivisions.—This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and does not contemplate that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain will be accounted for accordingly. If a loss results from the sale of capital assets, the amount of the loss to be deducted will be ascertained in a like manner as if a gain had been realized, and will be the amount by which the selling price is less than the value, as of March 1, 1913, or less than the cost, if acquired subsequent to that date, as the case may be. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶¶391, 392.)

12. "*Art. 118. Sale to other corporation.*—In determining the profits realized or the loss sustained upon the sale of capital assets by one corporation to another, payment therefor being made in the stocks or bonds of the purchasing corporation, the profit or loss, as the case may be, from such sale will be ascertained upon the basis of the difference between the cost of such assets to the seller, in case they were acquired subsequent to March 1, 1913, or the fair market value as of March 1, 1913, if acquired prior to that date, and the fair cash value of the stock or bonds at the time the sale was made. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶393.)

13. "*Art. 119. Sale by subsidiary to parent corporation.*—Where a subsidiary or other corporation sells or transfers its assets to a parent or other corporation, accepting in exchange therefor the stock or bonds of the purchasing corporation, the question of gain or loss resulting from this transaction will be determined upon the basis of the difference between the cost or market value as above indicated of the assets sold and the actual value of the stock or bonds given in exchange therefor. Any gain or loss thus ascertained as resulting from such a transaction will be added to or deducted from the entire gross income, as the case may be, of the selling corporation in the year in which the capital assets were sold. (T. D. 2077, 2137.)" (Reg. 33 (rev.), ¶394.)

14. "If, however, one corporation buys the assets of another and issues direct to the selling company its own capital stock in payment for the assets acquired, the transaction will be treated by the selling company as a sale of its assets, and the question as to whether profit or loss results from the sale will depend upon whether or not the value of the stock taken in payment for the assets is in excess of the fair market price or value as of March 1, 1913, of the assets sold or of their cost accordingly as they were acquired by the selling company prior or subsequent to that date.

If the value of the stock is so in excess, the amount of such excess will be taxable income for the year in which the assets were sold and must be so returned.

If the excess over value as of March 1, 1913, or over cost, as the case may be, includes any surplus earned since March 1, 1913, upon which the income tax has been paid, the excess or profits resulting from the sale may be reduced by the amount of such tax-paid surplus.

If the purchasing corporation takes over all the assets including accounts receivable, bills receivable, surplus, etc., of the selling corporation and assumes its liabilities, the amount so assumed will

be considered a part of the purchase price, and to the extent that the entire purchase price exceeds the cost or value, as of March 1, 1913, as the case may be of the assets disposed, income will accrue to the selling company." (Reg. 33 (rev.), ¶¶411-414.)

15. "*Art. 147. When deductible.*—The deduction for losses must represent losses not compensated for by insurance or otherwise and which were charged off and actually sustained within the year as evidenced by closed and completed transactions.

In the case of the sale of assets—real, personal, or mixed—the loss will be the difference between the cost thereof, or the value as of March 1, 1913, if acquired before that date, and the price at which disposed of. When the loss is claimed through the destruction of property by fire, flood, or other casualty the amount deductible will be the difference between the value as of March 1, 1913, or the cost of the property and the salvage value thereof, including in the latter value the amount, if any, that has been or should have been set aside and deducted in the current or previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained." (Reg. 33 (rev.), ¶458.)

16. "*Art. 157. Sale of patents.*—A corporation disposing of patents by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents since March 1, 1913, or since the date of purchase if acquired subsequent to that date." (Reg. 33 (rev.), ¶475.)

17. "*Good Will. Art. 167.*—'Good will' represents the value attached to a business over and above the value of the physical property, and is such an intangible asset that it is not subject to wear and tear, and no claim for depreciation in connection therewith can be allowed. Any loss resulting from or on account of an investment in 'good will' can be determined only when the property or business to which the good will attaches is sold or disposed of, in which case the profit or loss will be determined upon the basis of the value of the assets including good will if acquired prior to March 1, 1913, or their cost if acquired subsequent to that date." (Reg. 33 (rev.) ¶494.)

18. "*Art. 168. No deduction for depreciation of good will, trade-marks, and trade brands.*—No deduction will be allowed for the depreciation of good will, trade-marks, and trade brands. If such assets shall have been purchased at a determined price and shall be later sold at a price less than such cost or less than their determined fair market value as of March 1, 1913, if acquired prior to that date, the amount by which the selling price is less than the cost or value, as the case may be, will be a loss deductible from the gross income of the year in which such assets were sold." (Reg. 33 (rev.), ¶495.)

19. "*Sale of capital assets.*—For the purpose of ascertaining the gain or loss from sale or other disposition of ledger assets acquired prior to March 1, 1913, the fair market price or value of such assets as of March 1, 1913, shall be the basis for determining the amount of such gain or loss to be accounted for in the return of the year in which the assets are sold. If acquired subsequent to March 1, 1913, then the profit or loss to be returned or claimed will be the difference between the cost and the selling price." (Reg. 33 (rev.), ¶679.)

20. "*Losses actually sustained.*—Losses deductible (other than policy payments) must be distinguished from depreciation or allowances for exhaustion, wear and tear. The losses must be absolute, complete, actually sustained during the year, and charged off on the books of the company, and if the losses result from the sale of assets acquired prior to March 1, 1913, such losses shall be ascertained by taking the difference between the fair market price or value as of March 1, 1913, and the selling price. If the assets were acquired subsequent to March 1, 1913, the loss will be the amount by which the selling price is less than the *cost*." (Reg. 33 (rev.), ¶691.)

21. "The following propositions of law, stated for the information and guidance of internal-revenue officers and others concerned, are expressed or implied in the recent decisions of the Supreme Court of the United States in United States *v.* Biwabik Mining Co. (T. D. 2721), Goldfield Consolidated Mines Co. *v.* Scott (T. D. 2722), Doyle *v.* Mitchell Bros. Co. (T. D. 2723), Hays *v.* Gauley Mountain Coal Co. (T. D. 2724), United States *v.* Cleveland, Cincinnati, Chicago & St. Louis Railway Co. (T. D. 2725), William E. Peck & Co. (Inc.) *v.* Lowe (T. D. 2726), Lynch *v.* Turrish (T. D. 2729), Southern Pacific Co. *v.* Lowe (T. D. 2730), Lynch *v.* Hornby (T. D. 2731), and Peabody *v.* Eisner (T. D. 2732): . . .

(*b*) In order to determine whether there has been gain or loss on a sale, and the amount of the gain, if any, in general under all three acts, an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property or the capital value* that existed at the commencement of the period under consideration (either Jan. 1, 1909, or Mar. 1, 1913). . . .

* This wording taken from *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185.

For the purpose of the act of 1916, however, the fair market price or value as of March 1, 1913, to be ascertained in any practicable manner, is the statutory basis for determining the amount of gain on a sale of property acquired before that date. See regulations No. 31, T. D. 1578, T. D. 1588, T. D. 1606 (37, 71), T. D. 1675 (36, 55, 69), T. D. 1742 (42, 62, 86); articles 4, 90, 91, 92, 93, 101, 109, 111, 112, and 116 of regulations No. 33, revised, and T. D. 2649. Doyle *v.* Mitchell Bros. Co., Hays *v.* Gauley Mountain Coal Co., United States *v.* Cleveland, Cincinnati, Chicago & St. Louis Railway Co." (T. D. 2740.)

(2) As to depreciation and depletion:

1. "*Depletion—Timber.*—In the case of timberlands, the fair market price or value of timber standing March 1, 1913, or the cost of the timber where the purchase was made subsequent to March 1, 1913, will be the basis for calculation of depletion, and this value as of March 1, 1913, or cost when subsequently purchased, is not to be exceeded for purposes of deduction in returns of income. The whole of such value is to be distributed over the entire amount of standing timber on these respective dates. See Art. 173 of these regulations for rule of calculation." (Reg. 33 (rev.), ¶125.)

2. "*Art. 163. Value to be estimated, when.*—In determining the cost of the real estate upon which depreciable property is located it frequently occurs that no segregation is made of the cost of buildings as separate and distinct from the cost of the ground upon which such buildings stand. In such cases where the actual cost of the buildings or improvements at the time they were taken over by the corporation can not be definitely determined, it will be sufficient for the purpose of determining the rate of depreciation to be used in computing the amount which will be deductible from gross income to estimate the actual value

at the time acquired of buildings or improvements if acquired after March 1, 1913, or the fair market price or value as of that date if the property was acquired prior to March 1, 1913, the value in either case to be reduced by the amount of depreciation previously sustained. (T. D. 2137, 2152.)" (Reg. 33 (rev.), ¶488.)

3. "*Art. 170.* Sections 5 and 12 of the act of September 8, 1916, as amended by the act of October 3, 1917, authorize individuals and corporations owning and operating gas or oil properties, to deduct from gross income——

'A reasonable allowance . . . for actual reduction in flow and production, . . . provided that when the allowance authorized . . . shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made.'

The essence of this provision of law is that the owner or operator of this character of properties shall secure through an aggregate of annual depletion deductions, the return of the amount of capital actually invested, or an amount not in excess of the fair market value as of March 1, 1913, of the properties owned prior to that date." (Reg. 33 (rev.), ¶¶497-499.)

4. "In the case of the operating fee owner, the amount returnable through depletion deductions is the fair market value of the property (exclusive of the cost of physical property) as of March 1, 1913, if acquired prior to that date, or the actual cost of the property if acquired subsequent to that date, plus, in either case, the cost of development (other than the cost of physical property incident to such development) up to the point at which the income from the developed territory equals or exceeds the deductible expenses." (Reg. 33 (rev.), ¶501.)

5. "In the case of either an owner or lessee it will be required that an estimate, subject to the

approval of the Commissioner of Internal Revenue, shall be made of the probable quantity of oil or gas contained in or to be recovered from the territory with respect to which the investment is made. The invested capital (value as of Mar. 1, 1913, or cost, if acquired subsequent to that date, plus the cost of development, other than cost of physical property, up to the point of expense-paying production, in the case of an owner, and the amount actually paid for the lease plus cost of development, other than cost of physical property, up to the same point, in the case of a lessee) will be divided by the number of units of oil or gas so estimated to be contained in or to be recovered from the territory, and the quotient will be the per unit cost or amount of capital invested in each unit recoverable. This quotient, or per unit cost, when multiplied by the number of units removed from the territory during any one year, will determine the amount which may be allowably deducted from the gross income of that year on account of depletion of assets or as a return of invested capital until the total of such deductions shall equal the capital invested." (Reg. 33 (rev.), ¶504.)

6. "If the operator is the owner of the fee the value determined and set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date, or, if the operator is a lessee, the amount actually paid for the lease, plus, in the case of both owner and lessee, the cost of subsequent development, exclusive of physical property, if such cost is capitalized, will be the basis for determining the depletion deduction or the deduction for return of capital for all subsequent years during the continuance of the ownership under which the value was fixed or by which the investment was made, and during such ownership there can be no revaluation for the purpose of this deduction if it should be found that the quantity of oil or gas in the property was underestimated at

the time the value was fixed or the property was acquired, or at the time the lease contract was entered into or purchased." (Reg. 33 (rev.), ¶508.)

7. "To each return made by an individual or corporation owning and operating oil or gas properties there should be attached a statement showing—

(1) (*a*) The fair market value of the property (exclusive of machinery, equipment, etc.) as of March 1, 1913, if acquired prior to that date, or (*b*) the actual cost of the property if acquired subsequent to that date." (Reg. 33 (rev.), ¶¶512, 513.)

8. "*Art. 172.* If the property was acquired by purchase or otherwise (other than by lease) prior to March 1, 1913, the amount of invested capital which may be extinguished through annual depletion deductions from gross income will be the fair market value of the mine property so acquired, as of March 1, 1913. The value contemplated herein as the basis for depletion deductions authorized by this title must not be based upon the assumed saleable value of the output under current operative conditions, less cost of production, for the reason that the value so determined would comprehend the profits to be realized from operation of the property." (Reg. 33 (rev.), ¶530.)

9. "In cases wherein the quantity of the mineral deposit in the mine prior to March 1, 1913, can not be estimated with any degree of accuracy, it will be necessary, if depletion deductions are to be taken, for the individual or corporation owning the deposits, with the best information available, to arrive at the fair market value of the property as of March 1, 1913; that is, its fair cash value en bloc, if such value is believed to be other than its original cost, which value, during the period of the ownership under which it was determined shall be final and shall be charged to the property account

as hereinbefore indicated, and then, on the basis of the most probable number of units in the property, the per unit value shall be determined as the basis for computing annual depletion allowances, this method and allowances to be continued until, but not beyond, the time when the value as of March 1, 1913, shall have been extinguished." (Reg. 33 (rev.), ¶538.)

10. "*Art. 173.* Corporations owning timber land and logging off the timber and manufacturing it into lumber, will, if the timber was acquired prior to March 1, 1913, be permitted to exclude from gross income either through a deduction from gross receipts or through a charge into the cost of manufacturing the timber into lumber, an amount equivalent to the fair market price or value of the standing timber as of March 1, 1913." (Reg. 33 (rev.), ¶547.)

11. "Section 12 (a) of the act of September 8, 1916, as amended, to which section 5 (a) is similar, provides that net income shall be ascertained by deducting from gross income, among other things:

> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade.

A reasonable allowance for the wear and tear of property arising out of its use or employment in the business or trade is to be based on the cost of such property or on its fair market price or value as of March 1, 1913, if acquired prior thereto. In the absence of proof to the contrary, it will be assumed that such value as of March 1, 1913, is the cost of the property, less depreciation up to that date.

This decision is supplemental to articles 159 to 169, inclusive, of regulations No. 33 (revised), which to any necessary extent are modified accordingly." (T. D. 2754.)

III. Instructions contained in return forms

(1) For the year 1916:

"C. Profit from sale of land, buildings, and other property, real or personal.

1. Kind of Property (See instructions on page 2)	2. Year acquired	3. Sale Price	4. Cost

Total profit (Total of column 3 minus total of column 4)."

"C. Profit from sale of land, buildings, and other property, real or personal.

"*Kind of property.* Describe the property as definitely as you can in a word or two, as 'farm', 'dwelling', 'stocks', 'bonds', etc.

"*Cost.* Enter the original cost of the property, (or, if it was acquired before March 1, 1913, the fair market value on that date) plus the cost of any permanent improvements since made, less any deductions claimed in this return or in previous returns on account of wear and tear (depreciation) or depletion.

"If total cost of all property sold exceeded total sale price, the loss will not be allowed as a deduction unless the transactions formed part of your regular business."

(2) For the year 1917:

"C. PROFITS FROM SALE OF REAL ESTATE, STOCKS, BONDS, AND OTHER PROPERTY.

Kind of Property	2. Year acquired	3. Name and address of purchaser or broker.	4. Sale price	5. Original cost or market value Mar. 1, 1913	6. Cost of subsequent improvements, if any	7. Depreciation previously allowed.

tals,

t profits from sales (total of columns 4 and 7 minus totals of columns 5 and 6)

"C. PROFITS FROM SALE OF REAL ESTATE, STOCKS, BONDS, AND OTHER PROPERTY.

"COST. If the property was acquired before March 1, 1913, report the estimated market value on that date instead of the cost and explain the basis of your estimate.

"Expenses incidental to the purchase of property may be included in the cost if never claimed in income tax returns as a deduction from income.

"LOSSES. If total cost of all property sold exceeded total sale price, the loss will not be allowed as a deduction unless the sales out of which the loss arose were connected with your regular business. If a deduction is claimed on account of losses reported under C, explain what connection the sales had with your regular business and enter the amount of the loss under J, 'Other deductions' ".

B.

Revenue Act of 1918.

I. Statute

(1) As to gains and losses:

"That for the purposes of this title . . . the term 'gross income'—

(a) Includes gains, profits, and income derived from . . . sales, or dealings in property, whether real or personal, . . ." (Secs. 213 (a) and 233 (a).)

"That in computing net income there shall be allowed as deductions [in the case of an individual]: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise;" (Sec. 214 (a).)

"That in computing the net income of a corporation . . . there shall be allowed as deductions: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;" (Sec. 234 (a).)

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203." (Sec. 202 (a).)

"When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged." (Sec. 202 (b).)

(2) As to depreciation and depletion:

"That in computing net income there shall be allowed as deductions: . . .

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; . . .

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,*

That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; . . ." (Secs. 214 (a) and 234 (a).)

II. Regulations before March 28, 1921

(1) As to gains and losses:

1. "*Art. 39. Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of March 1, 1913, if purchased before that date, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, whether or not paid out of earnings or profits accrued since February 28, 1913, and in the case of stock in respect of which any such dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between the stock and securities purchased for the purpose of determining the portion of the consideration attributable to each class of stock or securities and so representing its cost, but if that should be impracticable

in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565. The entire amount realized from the sale of rights to subscribe for stock is income." (Reg. 45.)

2. "*Art. 40. Sale of patents and copyrights.*—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequently to that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequently thereto. See article 167." (Reg. 45.)

3. *Art. 41. Sale of good will.*—Any profit or loss resulting from an investment in good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for good will acquired after February 28, 1913, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold." (Reg. 45.)

4. "*Art. 43. Sale of real estate in lots.*—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of

March 1, 1913, or the cost, if acquired subsequently to that date, shall be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly." (Reg. 45.)

5. "*Art. 87. Income accruing prior to March 1, 1913.*—Property held by the taxpayer on March 1, 1913, is capital. Included in this capital are all claims, whether evidenced by writing or not, and all interest which had accrued thereon before that date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim contracted prior to March 1, 1913, is paid in whole or in part after that date, any gain derived from the conversion of the claim into money is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest), exclusive of any interest accrued since February 28, 1913, already returned as income, over the fair market value of the claim as of March 1, 1913 (both principal and interest then accrued). In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued

A claim for the purpose of this article means a right existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock. See section 201 of the statute and articles 1541-1549." (Reg. 45.)

6. "*Art. 141. Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. See section 202 of the statute and articles 39-46 and 1561. When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value thereof, after deducting from the cost or value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss in the sale of an individual's residence is not deductible. Losses in illegal transactions are not deductible." (Reg. 45.)

7. "*Art. 143. Loss of useful value.*—When through some change in business conditions the

usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-188." (Reg. 45.)

8. "*Art. 144. Shrinkage in securities and stocks.*—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of.

See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities, as to whom see article 1585. However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock was ascertained to be worthless and charged off, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151." (Reg. 45.)

9. "*Art. 545. Sale of capital assets.*—Where property is acquired and later sold for a higher price, the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the fair market value of such assets as of March 1, 1913, if acquired prior to that date, or over their cost if acquired subsequently to that date. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion and other losses which have been or should have been made. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563. If the sale is made for stock of another corporation, the rules

contained in section 202 of the statute and in articles 1561-1570 are particularly applicable." (Reg. 45.)

10. "*Art. 563. Sale of capital stock, bonds and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848. If the corporation sells its capital assets for less than their cost or fair market value as of March 1, 1913, the loss sustained is deductible. See article 545." (Reg. 45.)

11. "*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (*a*) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (*b*), if acquired on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. What the fair market price or value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581-1585. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831." (Reg. 45.)

12. "*Art. 1562. Sale of property acquired by gift or bequest.*—In the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior

thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73." (Reg. 45.)

13. "*Art. 1564. Determination of gain or loss from exchange of property.*—(*a*) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. (*b*) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old." (Reg. 45.)

14. "*Art. 1565. Exchange for different kinds of property.*—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the

bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property." (Reg. 45.)

15. "*Art. 1566. Exchange of property and stock.*—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. For the rule applicable where a corporation in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567." (Reg. 45, as amended Sept. 26, 1919.)

16. "*Art. 1569. Exchange of stock for other stock of greater par value.*—If in the case of any reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old and (*b*) the excess of the

fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (*a*) or (*b*), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange." (Reg. 45.)

(2) As to depreciation and depletion:

1. "*Art. 161. Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as covering depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844." (Reg. 45.)

2. "*Art. 201. Depletion of mines, oil and gas wells.*—A reasonable deduction from gross income for the depletion of natural deposits and for the depreciation of improvements is permitted, based (*a*) upon cost, if acquired after February 28, 1913, or (*b*) upon the fair market value as of March 1, 1913, if acquired prior thereto, or (*c*) upon the fair market value within 30 days after the date of discovery in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, where the fair market value is materially dispro-

portionate to the cost. The essence of this provision is that the owner of such property, whether it be a leasehold or freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to the fair market value as of March 1, 1913, of the properties owned prior to that date, or an amount equal to the fair market value within 30 days after the date of discovery of mines, oil or gas wells discovered by the taxpayer on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost; plus in any case the subsequent cost of plant and equipment (less salvage value) and underground and overground development, which is not chargeable to current operating expense, but not including land values for purposes other than the extraction of minerals. Operating owners, lessors and lessees are entitled to deduct an allowance for depletion, but a stockholder in a mining or oil or gas corporation is not. See further articles 839 and 844." (Reg. 45.)

III. Regulations after March 28, 1921

(1) As to gains and losses:

"Articles 39, 40, 41, 43, 48, 49, 87, 141, 143, 144, 545, 563, 1543, 1547, 1548, 1549, 1561, 1562, 1564, 1565, 1566, 1568, 1569, and 1570 of Regulations No. 45 (1920 ed.) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich *v.* Edwards and Brewster *v.* Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. The amendments are merely for the purpose of such incorporation and make no attempt to correct any of the regulations in any respect other than the one necessitated by those cases. The amendments are as follows:

Art. 39. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost of the stock will constitute gain. However, the gain which is taxable in the case where the stock was acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, is the excess of the amount realized by the sale over such value. No gain is recognized when stock is sold at more than its cost but at less than its fair market value as of March 1, 1913. In the case of stock in respect of which any stock dividend was paid, the cost of each share of such stock shall be ascertained as specified in article 1547. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. See article 1565 as amended. The entire amount realized from the sale of rights to subscribe for stock is income.

Art. 40. *Sale of patents and copyrights.*—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the cost. The taxable income in the case of patents or copyrights acquired prior to March 1, 1913, should be ascertained in accordance with the provisions of article 1561 as amended. The profit or loss thus ascertained should be increased or decreased, as the case may

be, by the amounts deducted on account of depreciation of such patents or copyrights since February 28, 1913, or since the date of acquisition if subsequent thereto. See article 167.

Art. 41. *Sale of good will.*—Any profit or loss resulting from a sale of good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will. If the good will was acquired prior to March 1, 1913, the taxable gain or deductible loss should be ascertained in accordance with the provisions of article 1561 as amended. If nothing was paid for good will acquired after February 28, 1913, no deductible loss with respect thereto is possible, although on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold. See article 163.

Art. 43. *Sale of real estate in lots.*—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such the cost shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income, may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for as provided in article 1561 as amended. . . .

Art. 87. *Income accruing prior to March 1, 1913.*—Any liquidated claim existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not; and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain which is taxable where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. No gain results where the amount received from the claim is more than the cost thereof but less than its fair market value as of March 1, 1913. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such property. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. Interest does not include dividends on corporate stock. See section 201 of the statute, and articles 1541-1549 as amended.

Art. 141. *Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by

nonresident aliens) if (*a*) incurred in a taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation), and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913. See section 202 of the statute, and articles 39-46 and 1561 as amended. When loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property and the salvage value thereof, after deducting from such cost, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. In the case of property acquired before March 1, 1913, when the fair market value as of that date is lower than the cost, the deductible loss is the difference between such value and the salvage value thereof after deducting from the value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. No loss is recognized where the salvage value is less than the cost but more than the depreciated value of such property as of March 1, 1913. In any event the loss should be reduced by the amount of any insur-

ance or other compensation received. See articles 49 and 50. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Losses in illegal transactions are not deductible. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom.

ART. 143. *Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost, or, if acquired prior to March 1, 1913, the cost or fair market price or value as of that date, whichever is lower, of any assets so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189.

ART. 144. *Shrinkage in securities and stocks.*—A person possessing securities, such as stock and bonds, can not deduct from gross income any amount claimed as a loss on account of shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. See, however, article 154. In the case of banks or other corporations which are subject to supervision by State or Federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. However, if stock of a corporation becomes worthless its cost, or if acquired prior to March 1, 1913, its cost or fair market value as of that date, whichever is lower, may be deducted by the owners in the taxable year in which the stock becomes worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151.

ART. 545. *Sale of capital assets.*—Where property is acquired and later sold for a higher price the gain on the sale is income. If, however, the property was acquired before March 1, 1913, only such portion of the gain as accrued subsequently to February 28, 1913, is taxable. Where, then, a corporation sells its capital assets in whole or in part it shall include in its gross income for the year in which the sale was made the amount of the excess of the sales price over the cost unless it acquired such assets prior to March 1, 1913, and the fair market value of such assets as of such date was in excess of the cost, in which case it shall include the excess of the amount of the sales price over such value. No gain or loss is recognized in case the assets are sold (*a*) at more than cost but at less than their fair market value as of March 1, 1913, or (*b*) at less than cost but at more than their

fair market value as of March 1, 1913. In every case, however, in ascertaining the gain, the cost of the assets, or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other deductions which have been or should have been taken. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the purchase price. See also article 563 as amended. If the sale is made for stock of another corporation, the rules contained in section 202 of the statute and in articles 1561-1570 as amended are particularly applicable.

ART. 563. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 542. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 544 and 848 as amended. If a corporation sells its capital assets for less than their cost, the loss sustained is deductible unless the assets were acquired before March 1, 1913, and sold at less than cost, but at more than their fair market value as of March 1, 1913. The loss which is deductible in the case where assets acquired before March 1, 1913, are sold after that date at less than cost and less than their fair market value as of that date, and such value was less than cost, is the difference between such price or value and the amount realized by the sale or exchange. See article 545 as amended.

. . . . . .

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired

on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581-1588. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831.

ART. 1562. *Sale of property acquired by gift or bequest.*—The cost of such property to the person making the sale or other disposition thereof is the fair market value of the property at the date of acquisition and the taxable gain derived or the deductible loss sustained from such sale or other disposition shall be computed in accordance with the provisions of article 1561 as amended. For the purpose of determining the profit or loss from sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of

State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (*b*) (3) of the statute and article 73.

ART. 1564. *Determination of gain or loss from exchange of property.*—(*a*) The amount of income derived from an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the property received in exchange over the original cost of the property exchanged for it. If the property exchanged was acquired prior to March 1, 1913, and its fair market value on that date was greater than the cost, the income which is taxable is the excess of the fair market value at the time of exchange of the property received in exchange over the fair market value on March 1, 1913, of the property exchanged. No gain is recognized if the fair market value of the property received in exchange is more than the cost of the property exchanged but less than its fair market value as of March 1, 1913. The amount of income derived from a subsequent sale for cash of property received in exchange for other property on or after March 1, 1913, is the excess of the amount so received over the fair market value of the property acquired at the date of the acquisition. (*b*) If the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old, and upon the sale of the new property the amount of income derived is the excess of the amount so received over the cost of the old. However, if the old was acquired prior to March 1, 1913, and its fair market value as of that date is in excess of its cost but less than the amount received, the taxable gain is the excess over such value as of March 1, 1913, of the amount received. No gain is recognized if the property is sold at more than the cost of the old property but at less than its fair market value as of March 1, 1913.

Art. 1565. *Exchange for different kinds of property.*—(*a*) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost. If the market value of the bonds is less than such cost the difference represents the cost of the stock. If the market value of the bonds is greater than such cost the difference represents gain and is taxable at the time of the exchange unless the original property was acquired prior to March 1, 1913, in which case the amount of gain taxable is computed as provided in article 1564 as amended. In either case the entire proceeds of such stock will be taxable. (*b*) If property is exchanged for two different kinds of property, such as bonds and stocks, neither having a fair market value, the cost of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost of the original property.

Art. 1566. *Exchange of property and stock.*—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction, and the former owner of the property realizes a gain or loss if the stock has a market value and such market value is greater or less than the cost of the property given in exchange. However, if the property was acquired prior to March 1, 1913, the amount of taxable gain or deductible loss shall be determined in accordance with article 1561 as amended. For the rule applicable where a corporation, in connection with a reorganization, merger, or consolidation, exchanges property for stock, see article 1567.

. . . . . .

ART. 1569. *Exchange of stock for other stock of greater par value.*—If in the case of any reorganization, merger, or consolidation, the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (*a*) the excess of the par or face value of the new stock or securities over the par or face value of the old, and (*b*) the excess of the fair market value of the new stock or securities over the cost of the old, unless the old stock or securities were acquired prior to March 1, 1913, and their fair market price or value as of that date was greater than their cost, in which case the fair market value of the new stock or securities must be in excess of the fair market value as of March 1, 1913, of the old. The taxable profit will be (*a*) or (*b*), whichever is less. On a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost of the old stock or securities plus the profit taxed on the exchange." (T. D. 3206, approved July 8, 1921.)

(2) As to depreciation and depletion:

The regulations with respect to deductions for depreciation and depletion were not amended following the decision in *Goodrich* v. *Edwards,* but remained as before. See page 33 above.

IV. INSTRUCTIONS ON RETURN FORMS

(1) For the years 1918, 1919 and 1920:

"D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY.

1. Kind of Property	2. Year acquired	3. Name and address of purchaser or broker	4. Sale Price	5. Original cost or market value Mar. 1, 1913	6. Cost of subsequent improvements, if any	7. Depreciation subsequently sustained

NET PROFIT FROM SALES (Total of columns 4 and 7 minus total of columns 5 and 6).

"Use this schedule for all sales of real estate, and for sales of other property that you did not deal in as a business.

"If the profits or losses on sales made through any one broker aggregated $1,000 or more, report the transaction on a separate line with the name and address of the broker.

"Kind of property. Describe the property as definitely as you can in a word or two, as 'farm', 'house', 'lot', 'stocks', 'bonds'.

"Sale price. State the actual consideration or price, or, in case of an exchange, the fair market value of the property received.

"Cost. Enter the original cost of the property or, if it was acquired before March 1, 1913, its fair market value on that date. Expenses incidental to the purchase may be included in the cost if never claimed in income-tax returns as deductions from income. Enter in column 7 the amount of wear and tear, obsolescence, or depletion sustained since March 1, 1913 (or since date of acquisition if subsequent to March 1, 1913). (This is a deduction from cost, though treated for convenience as an addition to the sale price.)

"Losses. If the total of columns 5 and 6 is in excess of the total of columns 4 and 7, report the difference as a loss by using red ink or a minus sign."

C.

Revenue Act of 1921

I. Statute

(1) As to gains and losses:

"That for the purposes of this title . . . the term 'gross income'—

(a) includes gains, profits, and income derived from . . . sales, or dealings in property, whether real or personal, . . ." (Secs. 213 (a) and 233 (a).)

"That in computing net income there shall be allowed as deductions [in the case of an individual]: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a non-resident alien individual only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title; . . .

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period. In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Sec. 214 (a).)

"That in computing the net income of a corporation . . . there shall be allowed as deductions: . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner

be accounted for as of a different period. . . . In case of losses arising from destruction of or damage to property, where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;" (Sec. 234 (a).)

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof;

(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition;

(3) In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property

at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402.

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income. (Sec. 202 (a) (b).)

(2) As to depreciation and depletion:

"That in computing net income there shall be allowed as deductions: . . .

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913; . . .

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable

allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted; *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And provided further,* That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; . . ." (Secs. 214 (a) and 234 (a).)

II. Regulations

(1) As to gains and losses:

The more material regulations of the Treasury Department for the administration of the pertinent provisions of the Revenue Act of 1921 relating to the determination of gains and losses derived from sales or dealings in property are substantially the same as the regulations after March 28, 1921, for the administration of the corresponding provisions of the Revenue Act of 1918. Those articles of the regulations for the administration of the pertinent provisions of the Revenue Act of 1921 which are a departure from the former regulations are reproduced below.

"*Art. 141. Losses.*—Losses sustained during the taxable year and not compensated for by in-

surance or otherwise are fully deductible (except by non-resident aliens) if (a) incurred in a taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft. They must usually be evidenced by closed and completed transactions.

In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained and allowable as a deduction in computing net income, and the price at which sold or disposed of. See article 1561. However, the loss which is deductible in the case where such property was acquired before March 1, 1913, and where its fair market value on that date was less than the cost thereof, is the difference between such value (less depreciation) and the price at which sold or disposed of. No loss is recognized in the case of property sold at less than cost minus depreciation but for more than its fair market value as of March 1, 1913, or for more than cost but less than the fair market value as of March 1, 1913. See section 202 of the statute and articles 39-46 and 1561.

When loss is claimed through the destruction of property by fire, flood, or other casualty, the amount deductible will be the difference between the cost of the property, less proper adjustment for depreciation, and the salvage value thereof. In the case of property acquired before March 1, 1913, however, the deductible loss is the difference between the fair market value of the property as of that date, less proper adjustment for depreciation, and the salvage value thereof. In any event the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 261-263. A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom." (Reg. 62, Art. 141.)

"*Art. 143. Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the cost, or, if acquired prior to March 1, 1913, fair market price or value as of that date of any assets so discarded (less any depreciation sustained and allowable as a deduction in computing net income) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189." (Reg. 62, Art. 143.)

"*Art. 144. Shrinkage in value of stocks.*—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or

otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. See, however, article 154. However, if stock of a corporation becomes worthless, its cost or other basis determined under section 202 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts. Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders or general policy of such supervisory officers charge off stock as worthless or write it down to a nominal value, such stock shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed for income tax purposes to be worthless. See article 151. For dealers in securities, see article 1585." (Reg. 62, Art. 144.)

"*Art. 563. Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. See article 543. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. See articles 545 and 848. If (1) a corporation sells its capital assets for less than their cost, and such assets were acquired before March 1, 1913, then if the fair market value on March 1, 1913, less depreciation subsequently sustained and allowable as a deduction is less than the amount realized, no loss is deductible; if (2) such fair market value less depreciation subsequently sustained and allowable as a deduction is greater than the amount realized, but the amount realized exceeds original cost, no loss is deductible; if (3) the amount realized is less than both original cost and the value of March 1, 1913, less depreciation subsequently

sustained and allowable as a deduction, the deductible loss is the difference between such amount realized and such cost or March 1, 1913, value, whichever is lower. See article 546." (Reg. 62, Art. 563.)

"*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property, the basis is the cost of such property, or in the case of property which should be included in the inventory, its latest inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain to be included in gross income is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made in computing gain or loss from the exchange or sale of property for any depreciation or depletion sustained and allowable as a deduction in computing net income; the amount of depreciation previously charged off by the taxpayer shall be deemed to be the true depreciation sustained unless shown by clear and convincing evidence to be incorrect. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. In the case of property traded in on public exchanges, evidence of actual sales at or about March 1, 1913, or other basic date, affords evidence of value, but it must not be regarded as conclusive. The nature and extent of the sales and the circumstances under

which they were made should be considered. Prices received at forced sales or for small lots of property may be and often are no real indication of the value of the amount of property in question. For instance, sales from time to time of a small number of shares of stock is little indication of the value of a large or controlling interest in the corporation. As to inventories, see section 203 of the statute and articles 1581-1588. As to sale of stock upon which dividends have been declared, see articles 1543, 1544 and 1546. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831. As to exchanges, see further, articles 1564-1568. If the taxpayer can not determine the cost of securities purchased prior to March 1, 1913, because of the loss, destruction or failure to keep records, the value of the securities at the date or approximate date of acquisition may be used in determining the cost basis for purposes of computing the gain or loss from the sale of the securities. When the date or approximate date of acquisition is unknown, no general rule can be stated for determining the cost value of such securities. Each case must be considered separately upon its own facts.

Illustrations of the computation of gain or loss from the sale or exchange of property acquired prior to March 1, 1913.—To avoid complexity no adjustment has been made in these examples for depreciation or depletion.

In the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the taxable gain is the excess of the amount realized therefor over such fair market value.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	*Taxable Gain*
$10,000	$15,000	$20,000	$5,000. Excess of amount realized over fair market value as at March 1, 1913. Gain attributable to the period prior to March 1, 1913, not taxable.

In the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	*Deductible Loss*
$10,000	$5,000	$3,000	$2,000. Excess of fair market value over amount realized. Loss attributable to the period prior to March 1, 1913, not deductible.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at more than cost but at less than its fair market value as of that date.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	
$10,000	$30,000	$20,000	No taxable gain or deductible loss. Reason: A gain on whole transaction, which gain is attributable to period prior to March 1, 1913.

No gain or loss is recognized in the case of property acquired before March 1, 1913, and sold or disposed of at less than cost but at more than its fair market value as of that date.

Cost	*Fair Market Value March 1, 1913*	*Sale Price*	
$10,000	$3,000	$5,000	No taxable gain or deductible loss. Reason: A loss on whole transaction, which loss is attributable to period prior to March 1, 1913.

Where the cost is equal to or greater than the fair market value as of March 1, 1913, and the selling price exceeds the cost, the gain to be included in gross income is the excess of the selling price over the cost.

Cost	Fair Market Value March 1, 1913	Sale Price	Taxable Gain
$10,000	$5,000	$20,000	$10,000. Reason: Gain on whole transaction, all of which is attributabel to period subsequent to March 1, 1913.

Where the fair market value as at March 1, 1913, is greater than the cost and the selling price is less than the cost, the deductible loss is the amount by which the cost exceeds the selling price.

Cost	Fair Market Value March 1, 1913	Sale Price	Deductible Loss
$10,000	$15,000	$5,000	$5,000. Reason: Loss on whole transaction, all of which is attributable to period subsequent to March 1, 1913. Only actual loss sustained deductible."

(Reg. 62, Art. 1561.)

"*Art. 1565. Determination of gain or loss from the exchange of property.*—The amount of income derived or loss sustained from an exchange of property is the difference between the fair market value (if readily realizable) at the time of the exchange of the property received in exchange and the original cost, or other basis, of the property exchanged. If the property exchanged was acquired prior to March 1, 1913, see article 1561." (Reg. 62, Art. 1565.)

(2) As to depreciation and depletion:

"*Art. 161. Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred

to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, and having due regard for expenditures made for current upkeep, at the end of such useful life to provide in place of the property its original cost (not replacement cost), or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844." (Reg. 62, Art. 161.)

"*Art. 201. Depletion of mines, oil and gas wells; depreciation of improvements.*—Sections 214 (a) (10) and 234 (a) (9) provide that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. These paragraphs of the statute are not materially different from the corresponding paragraphs of the Revenue Act of 1918. These provisions of the statute and articles 201-237 do not apply to or affect the regulations covering invested capital, losses, accounting methods, etc.

The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) the cost of his property if acquired subsequent to March 1, 1913, or (b) the value of his property on the basic date, plus subsequent allowable capital additions (see art. 222), but not including land values for purposes other than the extraction of minerals.

* * * * * *

When used in these articles (201—237) covering depletion and depreciation—

(a) The term 'basic date' indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto; the date of acquisition in the case of property acquired on or after March 1, 1913; or the date of discovery, or within 30 days thereafter, in the case of discovery." (Reg. 62, Art. 201.)

D.

Opinion of Attorney General.

"Department of Justice,
Washington,

August 23, 1922.

The Honorable,
The Secretary of the Treasury.

Sir:

"I have the honor to acknowledge receipt of your letter of June 26, 1922, in which you request my opinion as to the proper basis to be used, under the Revenue Acts of 1916, 1917 and 1918, in computing the taxable gain or deductible loss in the case where property, acquired prior to March 1, 1913, is sold or disposed of thereafter. Accompanying your letter was a brief submitted by the M Company in which the validity of the Regulations of the Internal Revenue and the procedure thereunder are questioned by the Company specifically as to the following cases:

"Where property acquired prior to March 1, 1913, is sold subsequent thereto at a price which is—

(a) Greater than the value thereof on March 1, 1913, which was higher than cost, or

(b) Greater than the cost thereof, which was higher than the value on March 1, 1913, or

(c) Greater than the value thereof on March 1, 1913, but less than cost, or

(d) Less than the value thereof on March 1, 1913, which was less than cost, or

(e) Less than the value thereof on March 1, 1913, but greater than cost, or

(f) Less than the cost thereof, which was less than the value on March 1, 1913.

The provisions of the Revenue Act of 1916 material to the subject under consideration, and not changed in any way by the Act of 1917, are:

> "Sec. 2. (a) That, subject to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from . . . businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> . . . . . .
>
> "(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.
>
> "Sec. 5. . . .
>
> "(a) For the purpose of the tax there shall be allowed as deductions—
>
> "Fourth. Losses actually sustained during the year, incurred in his business or trade, . . . *Provided,* That for the purpose of ascertaining the

loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

"Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;

. . . .

"Sec. 10. . . . For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company, or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained."

The Act of 1918, dealing with the questions propounded, are:

"Sec. 202 (a). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

"Sec. 213. That for the purposes of this title . . . the term 'gross income'—

"(a) Includes gains, profits, and income derived from . . . trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . . ."

Treasury Decision 3206 reads, in part, as follows:

"Regulations 45 (1920 Edition) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich *v.* Edwards, and Brewster *v.* Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. . . .

"*Art. 1561. Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (*a*) at more than cost but at less than its fair market value as of March 1, 1913, or (*b*) at less than cost but at more than its fair market value as of March 1, 1913. . . ."

In the case of Goodrich *v.* Edwards, 255 U. S. 527, the question of what constituted gain within the meaning of

the Revenue Act of 1916 was passed upon by the United States Supreme Court, which adopted a concession made by the Solicitor General to the effect that where no gain was realized by the taxpayer on a complete transaction, notwithstanding that the selling price was higher than the value on March 1, 1913, no tax should have been assessed against him; holding that section 2 (*c*) was applicable only where a gain over the original capital investment had been realized after March 1, 1913, from a sale or other disposition of property, establishing the rule that increases in value occurring prior to March 1, 1913, should be excluded in computing taxable gain, and that only increases occurring subsequent to such date should be taxed.

Taxable gain having been thus construed by the Supreme Court, it follows that "deductible loss" should have the same construction, the provisions relating to losses being practically identical with those relating to gain. In making the concession as to taxable gains, the Solicitor General, in his brief in the Goodrich cases, cited above, made the further concession that a loss on the complete transaction must have been sustained in order to make it a deductible loss, and that only the loss occurring subsequent to March 1, 1913, should be allowed as a deduction.

The provisions of the Revenue Act of 1918 which deal with the subject of taxable gains and deductible losses are:

> "Sec. 202 (*a*). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

"Sec. 213. That for the purpose of this title . . . the term 'gross income'—

"(*a*) Includes gains, profits, and income derived from . . . trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ."

No substantial changes having been made in the corresponding sections of the two Acts, it is assumed that both Acts were intended by Congress to have the same construction, and the same basis should be employed in arriving at taxable gains and deductible losses upon the sale or other disposition of property.

I am of the opinion that the date March 1, 1913, was intended to be used as a guide in ascertaining gains derived or losses sustained, but that the original cost should be taken into consideration, so that if there was no gain on the entire transaction there was no taxable gain, and if there was no loss on the entire transaction there was no deductible loss. It follows, therefore, that in limiting the M Company to the loss sustained by it on the sale of shares of stock of the O Company, that is, the difference between cost and selling price, instead of to the difference

between March 1, 1913, value and selling price, the Internal Revenue Bureau acted in accordance with law. In other words, the basis to be employed, under the Acts of 1916, 1917 and 1918, for the purpose of ascertaining the gain or loss from the sale or other disposition of property is the cost; and that in the case of property acquired prior to March 1, 1913, when its fair market value as of that date is in excess of its cost, the taxable gain is the excess of the amount realized over such fair market value; that when its fair market value as of March 1, 1913, is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor; and that when the property is sold or otherwise disposed of at more than cost but at less than March 1, 1913, value, or at less than cost but at more than March 1, 1913, value, neither taxable gain nor deductible loss results.

Replying specifically to the inquiry, I am of the opinion that where property acquired prior to March 1, 1913, is sold or disposed of thereafter—

(*a*) Taxable gain resulted if the selling price was higher than the value on March 1, 1913, and if that value was higher than the cost thereof, to the extent that the selling price exceeded the value on March 1, 1913;

(*b*) Taxable gain resulted if the selling price was greater than the cost and if the cost was greater than the value on March 1, 1913, to the extent that the selling price exceeded the cost of the property sold or disposed of;

(*c*) No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof;

(*d*) An allowable loss resulted if the selling price was less than the value on March 1, 1913, and if that value was less than the cost to the extent of the difference between the value on March 1, 1913, and the selling price;

(*e*) No taxable gain or deductible loss resulted if the selling price was less than the value thereof on March 1, 1913, but greater than the cost; or

(*f*) An allowable loss resulted if the selling price was less than the cost and if the cost was less than the value on March 1, 1913, to the extent that the cost of the property disposed of exceeded the selling price thereof.

Respectfully,

H. M. DAUGHERTY, Attorney General."

No. 733.

IN THE

Supreme Court of the United States

October Term, 1924.

Blakely D. McCaughn, United States Collector of Internal Revenue, *Petitioner*,

v.

Charles H. Ludington, *Respondent*.

Certiorari to a judgment of the Circuit Court of Appeals for the Third Circuit.

MEMORANDUM IN REPLY TO BRIEF FOR PETITIONER.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Of counsel for respondent.

Press of Byron S. Adams, Washington, D. C.

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MEMORANDUM IN REPLY TO BRIEF FOR PETITIONER.

As the brief on behalf of the petitioner was not served on the respondent's counsel until after the latter's brief had been printed and served, the following reply memorandum is filed on behalf of the respondent.

I.

The principal argument in the petitioner's brief is based upon the assumption, stated in various forms and ways, that Congress in the several Revenue Acts contemplated and intended to provide only for "actual loss" and not for "paper" or "fictitious" or "false" or "conjectural" loss; that to allow as a loss an actual and conceded depreciation "in the fair market price or value" as of March 1, 1913, would be an objectionable "gratuity," and that "a tax law is practical and deals with realities and not 'might-have-beens.'" (Petitioner's brief, pp. 5, 6, 7, 9, 13). This is supplemented by the contention that market valuation is a "false factor," that "the practical man gives little heed to temporary fluctuations in market values," and that "quoted market values are often highly conjectural" and often "fictitious."

The careful and distinctly significant language of Congress should also be noted. The basis and test were to be "the *fair* market price or value," for the patent purpose of excluding what the Government now urges (brief, p. 6) as "temporary fluctuations in market values."

It need, of course, only be recalled that "fair market value," instead of being a "false factor," is recognized in all civilized countries as the only generally acceptable factor, and that it is daily received and applied in all our courts as essentially the best and most reliable evidence of actual value. The petitioner, in demurring to the statement of claims (pp. 4-5), admitted on the record and for all purposes that in each case "the fair market value of said shares" was as alleged by the plaintiff.

The reasoning that market value is a "false factor" was supposed to have been long since refuted by the court itself. Thus, in the leading case of *Adams Express Company v. Ohio* 166 U. S. 185, 219, it was insistently urged at the bar by the counsel of the Express Companies that market value with its fluctuations was not a proper basis for determining value of property for taxation, because the so-called actual value of the physical property, for example, of the Adams Express Company was shown to be only $4,000,000, and that, although the market value of its shares was $16,800,000, such market value was ever subject to fluctuation and hence unreliable and a false and misleading factor in determining the true value of the Express Company's tangible and intangible property for purposes of taxation. The language then used by Mr. Justice Brewer, speaking for the court, seems to be quite in point in view of the present argument of the petitioner and particularly at p. 6 of his brief. Thus in 166 U. S. at p. 219 we find the following:

> "The first question to be considered, therefore, is whether there is belonging to these express companies intangible property—property differing from the tangible property—a property created by either the combined use or the manner of use of the separate articles of tangible property, or the grant or acquisition of franchises or privileges, or all together. To say that there can be no such intangible property, that it is something of no value, is to insult the common intelligence of every man.
>
> "Now, it is a cardinal rule which should never be forgotten that whatever property is worth for the purposes of income and sale, it is also worth for purposes of taxation. * * *

"But what a mockery of substantial justice it would be for a corporation, whose property is worth to its stockholders for the purpose of income and sale $16,800,000, to be adjudged liable for taxation upon only one-fourth of that amount. The value which property bears in the market, the amount for which its stock can be bought and sold, is the real value. Business men do not pay cash for property in moonshine or dreamland. They buy and pay for that which is of value in its power to produce income, or for purposes of sale. * * *

"In conclusion, let us say that this is eminently a practical age; that courts must recognize things as they are and as possessing a value which is accorded to them in the markets of the world, and that no finespun theories about situs should interfere to enable these large corporations, whose business is carried on through many States, to escape from bearing in each State such burden of taxation as a fair distribution of the actual value of their property among those States requires."

II.

As argued more or less fully in respondent's brief already filed at pp. 15-20, Congress intended that "the fair market price or value as of" March 1, 1913, should be taken as "the capital value," just as any individual in practical affairs, or any government officials for purpose of taxation or condemnation, would take any such "fair market price or value" as the best evidence and the most reliable factor in determining actual capital value. No ordinary business man in estimating or determining what was the *capital value* of his property would adopt *cost* if the fair market value thereof was substantially more or less than cost, and it would be little short of preposterous to argue at this

late day in a court of justice that for either taxation or condemnation purposes fair market value was not the best evidence of actual capital value.

After the decision of the court in *Doyle v. Mitchell*, 247 U. S. 179, 185 (cited at p. 20 of respondent's brief), the Treasury Department in T. D. 2740, under date of June 24, 1918, issued the following direction (*vide* App. p. 14):

> "(b) In order to determine whether there has been gain or loss on a sale, and the amount of the gain, if any, in general under all three acts" (*i. e.* Revenue Acts of 1909, 1916 and 1918), "an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property *or the capital value that existed at the commencement of the period under consideration* (*either January 1, 1909, or March 1, 1913*)." (Italics ours.)

When the Revenue Act of 1918 was amended in 1921 in view of the decision of this court in the *Goodrich* and *Walsh* cases (255 U. S. 527 and 536), the Report of the Committee on Finance of the Senate, presented in September, 1921, contained the following statement (at p. 10):

> "Section 202 provides in detailed form for the basis (used in the case of the sale or other disposition of property) for determining gain or loss. Because of the decisions of the Supreme Court in the case of *Goodrich v. Edwards* and *Walsh v. Brewster* (decided Mar. 28, 1921), it is necessary to state implicitly in the statute the method of treating gain or loss accrued prior to March 1, 1913. *Heretofore property held on March 1, 1913, has been considered capital as of its value on that date.* The concession of the Solicitor General in

the above cases, adopted by the court, is to the effect that gain or loss in every case is determined upon the basis of cost or acquisition value and not by the March 1 value of the property, the gain or loss accruing before March 1, 1913, however, being excluded for purposes of computing the net income subject to tax." (Italics ours.)

It was clearly the result of a misapprehension to state that this court in the *Goodrich* and *Walsh* cases had adopted the concession of the Solicitor General as to *losses!* Nothing in the opinion warranted any such assumption. In the *Goodrich* case it was stated in both brief and oral argument by counsel for the plaintiff-in-error (the writer of the present memorandum) that no question as to deductible losses was presented, that deductible losses involved quite different considerations, and that the attempt to couple them in the Solicitor General's brief was unwarranted. Furthermore, when the then Solicitor General replied he nevertheless sought to argue that his confession of error must be applied likewise to losses, but he was interrupted by the court, and he thereupon admitted that no question as to deductible losses was then presented, and was told that he need not argue any further as to losses if that point were not before the court.

In the Report of the Committee on Ways and Means of the House of Representatives, reporting the 1921 bill, the following statement was made as quoted in the petitioner's brief now before the court at p. 15:

> "Section 203. In the case of property acquired before March 1, 1913, under existing law, the basis for determining gain or loss is the fair market price or value of such property as of that date. The decision of the Supreme Court in the case of *Merchants Loan & Trust Co. v. Smietanka* (de-

> cided March 28, 1921), *makes necessary not a fundamental modification of that rule but a more detailed statement of its application.*" (Italics in petitioner's brief.)

Reference to the case cited, however, will show (255 U. S. 509) that it did not present any question as to taxable gains such as was involved in the *Goodrich* and *Walsh* cases, but on the contrary involved simply the appreciation of the value of securities, which it was contended was capital and not income at all. There was no question of losses. Yet, with all the emphasis of italics the statement of the Ways and Means Committee above quoted is now cited at p. 16 of petitioner's brief apparently to sustain the proposition that—

> "The law was not changed, but certain particulars were stated in detail, which before had been left to inference. And, always, in this as in the previous acts, loss and gain are considered correlative and interdependent."

(See also petitioner's brief at p. 12.)

It is submitted by respondent that as a matter of fact loss and gain had not been correlative and interdependent in any of the previous acts, as will be seen by reference to respondent's brief pp. 16, 17, 19.

III.

The constant repetition of the insistence of the Government that Congress was always dealing with *actual* losses determinable by *actual* cost may be inadvertently and unintentionally quite misleading, although, of course, in some cases deductible loss may be equivalent to actual loss.

Thus, the Revenue Act of 1913 allowed no deduction at all for capital losses in transactions, as in the case at bar, not connected with the taxpayer's business (respondent's brief p. 19), and the Act of 1916 allowed the deduction only to the extent of "the losses *actually* sustained therein during the year to an amount not exceeding the profits arising therefrom."

Under none of the Revenue Acts has *actual* loss determined by *actual* cost been generally allowed as a deduction. Under the Acts of 1918 and 1921, if property had been purchased prior to March 1, 1913, no deductible loss was allowed unless the selling price was less than the fair market price or value on that date. For example, under these statutes, if property which cost $100,000 prior to March 1, 1913, was only of the fair market value of $50,000, as of that date, and was subsequently sold for $50,000, not one dollar of loss was deductible although the *actual* loss determined by cost would manifestly be $50,000. Whilst under the Act of 1924 there would be a deductible loss of $50,000 because cost was "greater" than market value as of March 1, 1913.

The argument that Congress in any of the Acts intended gains and losses to be correlative and interdependent or that it intended to establish (as argued in the *Flannery* case, No. 527 at p. 11) "a uniform, harmonious, and consistent basis" will be readily refuted by reference to other provisions of the several statutes and the regulations then in force and which are still enforced unamended.

An examination of the several Revenue Acts will conclusively show that Congress must have constantly had in mind the two bases or standards of cost and market value as of March 1, 1913; that it intentionally

differentiated between them, and that it must have meant what it repeatedly said as to fair market value *instead of cost* in respect of property acquired before that date. For particular examples, we may refer to the statutory provisions as to inventories, destruction of or damage to property, exhaustion, wear and tear, depreciation and depletion: in every such case the fair market value on March 1, 1913, was fixed as the basis in respect of property acquired before that date and not its cost or capital invested therein (App. 5-6, 23, 24, 47, 49). The contrary statement on page 8 of petitioner's brief must be an inadvertent error, for it is clearly in conflict with the Act of 1918 and the Regulations. (App. 23-4, 27, 33-4.) The Department so construed the statute in the most explicit terms (App. 7, 9, 13, 15, 18, 20-1, 25, 27, 29, 33-4). And as stated on p. 45 of the appendix to respondent's brief (not challenged by petitioner), the regulations as to deductions for depreciation and depletion have not been amended since the decision in the *Goodrich* and *Walsh* cases.

IV.

The brief on behalf of petitioner urges (p. 19) that the construction given to existing laws by the executive officials charged with their enforcement is entitled to great weight. That rule, of course, is very well settled. Both sides urge its soundness and applicability. The respondent, however, contends that it should be enforced for his protection as a taxpayer. For more than five years in all regulations and forms prescribed for income tax returns fair market value as of March 1, 1913, was consistently prescribed by the executive offi-

cials charged with the enforcement of the law (Respondent's brief, p. 40). Innumerable taxpayers acted and relied upon this governmental construction, and it is surely as great a hardship as it is an injustice to be mulcted years afterwards and compelled to pay additional income taxes by reason of a belated change of construction by the Department. No more confusion will result from upholding the original and long enforced construction than from setting it aside in favor of the later construction which was based upon a misapprehension of the effect of the decision in the *Goodrich* and *Walsh* cases. The statement that the subsequent rulings have been "accepted" to be found at p. 21 of petitioner's brief is hardly warranted by the facts, for the records of the Department show the contrary and the challenge from the beginning of the correctness of the new construction by numerous taxpayers.

Nor is it fair to compare the plaintiff-respondent to speculators in the market or to suggest that he is seeking a gratuity without equity thereto. The tax for 1919 which he originally paid without protest or claim of reduction was $86,754.46, but he was compelled to pay a total of $91,682.40 including the $3,094 now in controversy based on the high rate of 68 per cent. There is no element of speculation or "playing the market," as the current phrase puts it, for the securities involved had been concededly acquired by the plaintiff prior to March 1, 1913, and had been held by him for at least six years (p. 3).

V.

As to the New York cases relied on by petitioner, it need only be said that they adopted the erroneous view

of the Attorney General of the United States as to the *Goodrich* and *Walsh* cases applying to losses. *People ex rel. Klauber v. Wendell*, 196 App. Div. 827, and *People ex rel. Keim v. Wendell*, 200 App. Div. 388. This is true likewise of the later decision in *Matter of Bush v. Law*, 206 App. Div. 800, which merely followed the two prior cases. But in the meantime, as Mr. Justice Hasbrouck points out (at p. 802) in his able and persuasive dissenting opinion in the last cited case, the New York Tax Law was amended by the Legislature (Laws 1921, ch. 573) so as to add the following:

> "No loss shall be deemed to have been sustained if either *the cost or* the fair market price or value on January 1, 1919, is less than the value realized."

Washington, January 12, 1925.

William D. Guthrie,
Hugh Satterlee,
William R. Perkins,
Of counsel for respondent.

No. 733

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924

BLAKELY D. McCAUGHN, United States
Collector of Internal Revenue,

Petitioner

v.

CHARLES H. LUDINGTON,

Respondent

PETITION FOR REHEARING
of Charles H. Ludington, Respondent

HUGH SATTERLEE,
WILLIAM R. PERKINS,
RALPH B. EVANS,
Of Counsel for Respondent

TABLE OF CASES CITED.

ADDITIONAL CITATIONS.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924.

No. 733—CERTIORARI TO A JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BLAKELY D. MCCAUGHN, United States Collector of Internal Revenue,
Petitioner,

vs.

CHARLES H. LUDINGTON,
Respondent.

PETITION FOR REHEARING

TO THE HONORABLE THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Charles H. Ludington, respondent in this cause, respectfully moves the Court for a rehearing, upon the grounds stated below.

Summary of Grounds for Rehearing.

1. The present *Flannery* and *Ludington* decisions reverse all the contemporaneous Treasury regulations under the 1916 and 1918 Acts regarding **loss from sale** (p. 4).

2. The Treasury regulations under the 1916 Act, so reversed, were ratified and adopted by the 1918 Act (p. 5).

3. The present decisions conflict with *Goodrich* v. *Edwards,* which decided that cost or March 1, 1913 value, **whichever is higher,** should be the basis for determining **gain.** The same basis should be applied in determining **loss from sale** (p. 5).

4. The present decisions conflict with *Lynch* v. *Alworth-Stephens Company,* decided by this Court March 2, 1925, which allowed **loss from depletion** based on March 1, 1913 value **higher than cost** (p. 7).

5. The present decisions conflict with the Treasury regulations under the 1916 and 1918 Acts, which allow **loss from depreciation** based on March 1, 1913 value **higher than cost** (p. 8).

6. The present decisions conflict with the Treasury regulations under a similar provision of the 1921 Act, which allow **loss from casualty** based on March 1, 1913 value **higher than cost** (p. 11).

7. The case of **loss from sale** is the only situation in which taxpayers have been denied the benefit of March 1, 1913 value **higher than cost** (p. 12).

8. The present decisions disregard the reference in Section 202 (a) to **inventory value,** which expressly sanctions a basis **more favorable than cost** (p. 14).

9. The present decisions conflict with the intention of Congress to preserve to every taxpayer the full benefit of capital value at March 1, 1913 (p. 15).

10. Losses from March 1, 1913 value are actual losses (p. 16).

11. The present decisions create inequality and tend to confusion in the administration of the revenue acts (p. 17).

12. The present decisions conflict with the Court's doctrine that any doubt in the statute should be resolved in favor of the taxpayer, which requires that the same basis be adopted for **loss from sale** as for **gains** and for losses from **depreciation,** from **depletion,** and from **casualty** (p. 19).

The 1918 Act and the Present Decisions.

The question involved is the construction of Section 202 (a) of the Revenue Act of 1918:

> "That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

The Court has held in this case and in *United States* v. *Flannery,* No. 527, concurrently decided, that under §202 (a) the basis for ascertaining loss from sale of property acquired before March 1, 1913, is cost or March 1, 1913 value, **whichever is lower**. Mr. Justice McReynolds and Mr. Justice Sutherland dissented, and we are informed that Mr. Justice Stone did not participate in the decision.

The Court has thus reversed, by a vote of six to two, the unanimous judgments of the Circuit Court of Appeals in the present (*Ludington*) case and of the Court of Claims in the *Flannery* case. The present decisions also overrule the carefully considered determination of the Board of Tax Appeals in *Appeal of Even Realty Co.* (January 16, 1925), 1 B. T. A. 355, 364, and the decision in *Vance* v. *McLaughlin, Collector* (U. S. D. C. California, April 15, 1924), Prentice-Hall Federal Tax Service 1924, paragraph 2804B; Corporation Trust Company, Federal Income Tax Service 1925, paragraph 1549D.

Grounds for Rehearing.

1. The Flannery and Ludington decisions reverse all the contemporaneous Treasury regulations and rulings under the 1916 and 1918 Acts regarding loss from sale, which adopted March 1, 1913 value as the basis even where such value was higher than cost. The opinions make no reference to the regulations and rulings so reversed.

The rulings so reversed were relied upon in all business transactions from 1916 through 1920 (the years during which the 1916 and 1918 Acts were in effect) and in the audit of all returns for those years until July, 1921. In the *Flannery* case the Court said:

> "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons."

The effect of the present decisions is retroactively "to neutralize a loss occurring after the incidence of the tax [March 1, 1913] by an admittedly non-taxable gain occurring prior to the incidence of the tax." *Holmes Federal Taxes* (Sixth Edition), p. 708 (criticizing the Government contention). Disallowing such losses works a retroactive forfeiture in the case of those taxpayers who relied on the uniform interpretations of the statute by the Bureau and by other authorities. These interpretations are fairly illustrated by the extracts and citations appended in Schedule A to this petition.

The *Goodrich, Brewster, Klauber, Keim* and *Bush* decisions, upon which the *Flannery* decision rests, were all rendered after December 31, 1920, when the provisions of the 1918 Act for ascertaining gain and loss had ceased to be effective.

The Acts of 1921 and 1924 do not present the question here involved, and no business interests could be adversely affected by a decision allowing the deductions for loss claimed in this case and in the *Flannery* case.

2. The Treasury regulations and rulings under the 1916 Act, reversed in the Flannery and Ludington decisions, were ratified and adopted by the 1918 Act.

The 1918 Act, containing provisions corresponding to those of the 1916 Act, was enacted by Congress on February 24, 1919, with full knowledge of the Treasury Department's uniform construction of the 1916 Act, ever since its enactment, as authorizing the deduction of losses on the basis of March 1, 1913 value, regardless of whether such value were higher than cost.

> *National Lead Company* v. *United States* (1920), 252 U. S. 140, 146.

See the regulations and rulings under the 1916 Act quoted in Schedule A appended to this petition, and particularly the questions and answers from the *Income Tax Primer* on page 24.

Even if the *Goodrich* case be deemed to limit loss deductions to losses from cost, and even if the differences in phraseology between the 1916 and 1918 Acts be disregarded, the *Goodrich* decision under the 1916 Act would not justify the *Flannery* and *Ludington* decisions under the 1918 Act, because the 1918 Act must be construed as adopting the existing regulations and rulings.

We submit, however, that the *Goodrich* decision is entirely in accord with our contentions.

3. Goodrich v. Edwards (1921), 255 U. S. 527, decided that cost or March 1, 1913 value, whichever is higher, should be the basis for determining gain. The same basis should be applied in determining loss.

In the *Goodrich* case this Court held that cost or March 1, 1913 value, **whichever was higher**, should be used as the basis for determining taxable gain. In the *Ludington* and *Flannery* cases the Court has assumed to give "a corresponding effect" to March 1, 1913 value in the case of taxable losses, but has in fact fixed a wholly

different basis, to wit, cost or March 1, 1913 value, whichever is lower.

Having regard to substance, the provision as to losses should be given the same effect and not "a corresponding effect" to that given in the case of gains.

The reason for a rule should determine the extent of its application. The exemption from income taxation of all capital values existing March 1, 1913 is equitable, and the further exemption, established by the *Goodrich* and *Brewster* cases, of cost (capital investment) may likewise be regarded as equitable. The considerations favoring such exemptions, however, do not justify giving the statute "a corresponding effect" in the case of losses by denying to taxpayers the benefit of their capital values existing March 1, 1913. The point actually decided in the *Goodrich* case (as distinguished from the observations of the Solicitor General) does not warrant such indirect impairment of March 1, 1913 values.

Doyle v. *Mitchell Brothers Co.* (1918), 247 U. S. 179.
Lynch v. *Turrish* (1918), 247 U. S. 221.
State ex rel. Bundy v. *Nygaard* (1916), 163 Wisc. 307, 158 N. W. 87 (not cited on the original argument).

The *Nygaard* case was decided by the Wisconsin Supreme Court in the January Term, 1916, whereas the *Goodrich, Brewster* and New York decisions were rendered after 1920. In the *Nygaard* case the Court denied the right of the legislature to tax appreciation in capital values arising prior to the enactment of the first income tax law (1911), the Court saying:

> "In the judgment of the court all of this was capital, or, in other words, property. Its status was fixed. No part of it could be made into income by legislative enactment. It was subject to taxation as property under the uniformity rule, but not otherwise."

4. The Flannery and Ludington decisions are inconsistent with the decision of this Court in Lynch v. Alworth-Stephens Company, rendered March 2, 1925, and with the Treasury regulations and rulings under the 1916 and 1918 Acts, regarding loss from depletion, which agree in adopting March 1, 1913 value as the basis where such value is higher than cost.

The 1916 Act provided in Sections 5 and 12 for a reasonable allowance for depletion of mines and mineral wells, limiting the aggregate allowance to "the capital originally invested, or, in case of purchase made prior to March 1st, 1913, the fair market value as of that date."

The 1918 Act provided in Sections 214 and 234 for a reasonable allowance for depletion of mining and mineral properties, except

> "That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date."

These statutory provisions were uniformly construed by the Treasury Department to authorize the March 1, 1913 value as the basis of depletion deductions where such value, as was true in most cases, was higher than cost. Even after the decision of this Court in the *Goodrich case*, the Treasury Department made no change in its regulations relating to depletion.

The recent decision of this Court in **Lynch v. Alworth-Stephens Company** has confirmed and approved the Treasury Department's uniform construction of the provisions of the 1916 and 1918 Acts relating to loss from depletion, which differ in no material particular from the statutory provisions relating to loss from sale.

The intention of Congress, as interpreted by this Court in the *Alworth-Stephens* case and by the Treasury Department in all its regulations, is further indicated by the provision in Sections 214 and 234 of the Act of 1918 (immediately following the provision with respect to depletion above referred to) that in the case of mineral properties discovered by the taxpayer on or after March 1, 1913, in certain circumstances "the depletion allowance shall be based upon the fair market value of the property at the date of the discovery or within thirty days thereafter." This provision was unmistakably intended to give the taxpayer the benefit of a higher depletion base than cost or even March 1, 1913 value, and has been uniformly so construed by the Treasury Department.

This discovery provision is entirely inconsistent with the thought that Congress, in referring to losses, had in mind only so-called "actual losses" based on cost.

5. The Flannery and Ludington decisions are inconsistent with the Treasury regulations and rulings under the 1916 and 1918 Acts regarding loss from depreciation, which adopted March 1, 1913 value as the basis where such value was higher than cost.

The 1916 Act in Section 12 provided for the deduction from gross income of

> "All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade."

The Treasury regulations were at first not clear whether exhaustion, wear and tear (or in other words, depreciation) was intended to have the same basis as

losses from sales in the case of property acquired before March 1, 1913 (*i. e.*, the value on that date). But by Treasury Decision 2754, approved August 23, 1918, all doubts were set at rest, and it was specifically ruled that

> "A reasonable allowance for the wear and tear of property arising out of its use or employment in the business or trade is to be based on the cost of such property or on its fair market price or value as of March 1, 1913, if acquired prior thereto."

In *Law Opinion No. 612* of the Solicitor of Internal Revenue, dated August 15, 1918, on which Treasury Decision 2754, above referred to, was based, the Solicitor relied on the following passage from the opinion of this Court in *Doyle* v. *Mitchell Brothers Company* (1918), 247 U. S. 179:

> "When the Act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and a subsequent change of form by conversion into money did not change the essence. * * *
>
> "It may be observed that it is a mere question of methods, not affecting the result, whether the amount necessary to be withdrawn in order to preserve capital intact should be deducted from gross receipts in the process of ascertaining gross income, or should be deducted from gross income in the form of a depreciation account in the process of determining net income. In either case the object is to distinguish capital previously existing from income taxable under the Act."

The 1918 Act provided in Sections 214 and 234 for a reasonable allowance for the exhaustion, wear and tear of property, but without expressly specifying any basis in the case of property acquired before March 1, 1913. The Treasury regulations, however, following the interpretation of the 1916 Act, uniformly construed this statutory provision in the light of the other provisions of

the Act with reference to the determination of losses, as authorizing the use of March 1, 1913 value as the basis for depreciation in the case of property acquired before that date. Such regulations have not been changed since the decision of this Court in the *Goodrich* case was handed down.

Thus, in all cases arising under the 1916 and 1918 Acts, where March 1, 1913 value was higher than cost, loss from depreciation has been allowed on the basis of the March 1, 1913 value, although **the only support for such construction of the law and for such practice has been the analogy of the provisions of those statutes relating to the determination of loss on sales of property.** These provisions the ***Flannery*** and ***Ludington*** decisions have now construed to limit the deduction of losses from sale to cost where the March 1, 1913 value was higher than cost. If no relief be had from this intolerable situation, the Treasury Department may attempt to revise its regulations with respect to depreciation under the 1916 and 1918 Acts and to reopen and redetermine all cases under those Acts against which the statute of limitations shall not already have run.

In a **Statement by Mr. A. W. Gregg (now Solicitor of Internal Revenue)** issued by the Treasury Department in explanation of the changes from the Revenue Act of 1921, proposed in the Treasury draft of the Revenue Bill of 1924, appears the following comment on what corresponded to the present Section 204 (c):

> "(8) The first part of subdivision (b) of the draft, that is, the part preceding the exceptions, does not correspond to any provision of the existing law, but is the same as the interpretation placed upon the existing law by the Department. **It provides that the basis of computing depreciation and depletion shall be the same as the basis of computing gain or loss from the sale of prop-**

> erty, and represents what is obviously the correct rule, since the theory in setting a basis for depreciation and depletion is the same as in setting one for determining gain or loss from sale; that is, to insure a taxpayer a return of his capital free from tax."

The confusion which would arise from the use of a basis for loss from sale different from the basis for loss from depreciation is well illustrated by the *Appeal of Even Realty Company* (1925), 1 Board of Tax Appeals Reports 355, an extract from which is attached as Schedule B to this petition.

6. The Flannery and Ludington decisions are inconsistent with the Treasury regulations and rulings under the 1921 Act regarding loss from casualty, which adopted March 1, 1913 value as the basis where such value was higher than cost.

The 1918 Act provided in Section 214 for the deduction from gross income of loss from casualty. Regulations 45 under the 1918 Act provided in Article 141 that loss from casualty, as well as loss on the sale of property, should be based on the fair market value as of March 1, 1913, in the case of property acquired before that date. After the decision of this Court in the *Goodrich* case, Article 141 was amended by Treasury Decision 3206, approved July 8, 1921, to provide that loss from casualty, as well as from sale, should be based on cost where March 1, 1913 value was higher than cost.

The 1921 Act, in the case of loss from sale, embodied in elaborate language the rule now laid down by this Court in the *Flannery* and *Ludington* decisions, but in the case of loss from the destruction of property provided in Section 214 that "where the property so destroyed or damaged was acquired before March 1, 1913,

the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913." Regulations 62 under the Act of 1921 provided in Article 141 that **loss from the sale** of property should be determined in accordance with the rule now embodied in the *Flannery* and *Ludington* decisions, but that **loss from casualty** should be based on the March 1, 1913 value of the property, where acquired before that date.

Thus the Treasury Department admits, and no one disputes, that March 1, 1913 value is the basis **even where such value was higher than cost** under the following provision of the 1921 Act relative to loss from casualty:

> "where the property so destroyed or damaged was acquired before March 1, 1913, the deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;"

although, after the decision of this Court in the *Goodrich* case, the Treasury Department reversed a like construction of the similar provision in the 1918 Act in respect of loss from sale, which required that the basis should be

> "in the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date".

7. The case of a loss from the sale of property acquired before March 1, 1913, is the only situation under any of the revenue acts in which taxpayers have been denied the benefit of capital value existing on March 1, 1913, in excess of cost.

As to gain from sale, under the 1916 and 1918 Acts the Treasury Department has uniformly ruled that the March 1, 1913 value of property acquired prior thereto was the basis if such value was higher than cost. This Court in the *Goodrich* case held, and the Treasury De-

partment thereafter ruled, that in all cases of gain from sale the basis should be cost or March 1, 1913 value, **whichever was higher.**

As to loss from depreciation and depletion, under both the 1916 and 1918 Acts the Treasury Department has uniformly ruled that the March 1, 1913 value of property acquired prior thereto was the basis, where such value was higher than cost. On the other hand, the Treasury Department has never limited taxpayers to the basis of March 1, 1913 value where cost was higher than such value, so that taxpayers have uniformly been allowed deductions for depreciation and depletion based on cost or March 1, 1913 value, **whichever was higher.**

As to loss from casualty, under both the 1916 and 1918 Acts the Treasury Department consistently ruled, prior to the decision of this Court in the *Goodrich* case, that the March 1, 1913 value of property acquired prior thereto was the basis where such value was higher than cost. After the decision of this Court in the *Goodrich* case the Treasury Department ruled, in assumed compliance with the principle of such decision, that cost was the basis for ascertaining loss from casualty where March 1, 1913 value was higher than cost; but the Treasury Department reverted to its original view in construing a provision of the 1921 Act relating to loss from casualty which was similar to the provision of the 1918 Act relating to loss from sale.

Following the decision of this Court in the *Goodrich* case the Treasury Department, which had opposed the concession of the Solicitor General with respect to the determination of gain, felt impelled to derive some advantage from that decision by attempting to limit loss from sale. This view it persuaded Congress to embody in the 1921 Act, then in course of passage. The complications resulting from a treatment of loss from sale at variance with the treatment of losses from depreciation, from de-

pletion and from casualty, however, brought about the omission from the 1924 Act of all the elaborate and illogical machinery for the determination of loss from sale differently from other losses and from gains, and the substitution, in Section 204(b) of the 1924 Act, of the simple and logical provision that the basis for determining **gain or loss** from the sale of property acquired before March 1, 1913, should be the cost or the fair market value as of March 1, 1913, **whichever was greater.**

8. The reference to inventory value in Section 202 (a) above quoted is a clear recognition of a basis which may result in loss greater than loss computed on a cost basis, and is inconsistent with the theory that Section 202 (a) contemplated only the deduction of what the Court calls "actual losses".

The 1918 Act provides that for the purpose of ascertaining the loss sustained from a sale of property the basis shall be, in the case of property acquired on or after March 1, 1913, the cost thereof, "or the inventory value, if the inventory is made in accordance with Section 203." Section 203, thus referred to, provides that whenever the use of inventories is necessary, they shall be taken upon such basis as the Commissioner may prescribe as conforming as nearly as may be to the best accounting practice and as most clearly reflecting the income. Pursuant to the authority so granted by Congress the **Treasury Department has sanctioned the taking of inventories at cost, or at cost or market whichever is lower, and in the case of dealers in securities even at market, although higher than cost.**

Consequently, if a dealer in securities takes his inventory at the beginning of the year at a market higher than cost, and his inventory at the end of the year at a lower market, which may still be higher than cost, he is

entitled to deduct the loss thus computed. Similarly, in the case of another merchant who takes his inventory at the beginning of the year at cost or market whichever is lower, and his inventory at the end of the year at a lower figure, because market value has dropped, he is entitled to deduct the loss thus computed, although he has not yet sold the goods at a price lower than cost.

Congress therefore had clearly in mind in drafting Section 202 (a) that losses computed pursuant to its provisions might often be greater than if limited to so-called "actual losses" on a basis of cost.

9. The Flannery and Ludington decisions are in direct conflict with the intention of Congress, which was to preserve to every taxpayer the full benefit of the capital value of his property at March 1, 1913.

The references to March 1, 1913 in the Revenue Act of 1916 originated in a single series of amendments covering not only loss from sales, but also losses from depreciation, depletion and casualty. In this connection Representative Kitchin, who was in charge of the bill as Chairman of the Committee on Ways and Means, said (53 Congressional Record, Part 11, p. 10727):

> "Mr. Kitchin. The constitutional amendment providing for an income tax went into effect on March 1, 1913, and we think that the value at that time, and not what was paid for it perhaps 10 or 15 years before the constitutional amendment took effect, should control."

This viewpoint of Chairman Kitchin was amplified in his discussion of a corresponding provision in the Revenue Bill of 1918 (56 Congressional Record, Part 10, p. 10350):

> "Mr. Kitchin. There is a very good reason. I assumed every gentlemen in the House, I thought

> even the gentleman from Texas, understood why we had to put March 1, 1913, into the statute, because before March 1, 1913, Congress had no constitutional power to levy an income tax. The income-tax amendment did not become effective until March 1, 1913. All gain, to which the gentleman referred, which had accrued before Congress had the power to pass an income tax could not be taxed, and therefore we had to say that in the case of property purchased before March 1, 1913, it matters not what its value, must be taken as of that date, because if I bought a piece of property of $10,000 and on March 1, 1913, it was worth $20,000, my income or profit is $10,000, and as that gain accrued before Congress had the power to enact an income tax, it could not be taxed."

In the course of the same discussion Representative Fordney, who was also a member of the Committee in charge of the bill, said (*id.* 10352):

> "Mr. Fordney. If you purchased a piece of property before March 1, 1913, you can take the value on that date as your investment in that property, and whatever you sell that property for over and above that value is income, on which you must pay the tax. Now, if you purchased it after March 1, 1913, there is no question as to its value. Its value is what you paid for it, and when you sell it this year the difference between what you paid for it and what you get for it is profit, and on that you pay an income tax. That is the law. I can not make it any plainer than that."

10. The Flannery and Ludington decisions appear to be erroneous in assuming that losses from March 1, 1913 value are not "actual losses".

It is respectfully submitted that the Court here overlooks the "time" or periodical element in the computation of income and losses; that where property has an actual market value on March 1, 1913, a subsequent sale for less than such market value involves an actual loss for

the period from March 1, 1913 to the date of sale; and that (whether or not losses from dates prior to March 1, 1913, would be deductible), there is no ground for denying deductions from March 1, 1913 values as not representing "actual losses".

A recognized purpose of the income tax is to apportion the tax burden in accordance with ability to pay. With this in view, it was equitable for Congress to start all taxpayers on a common basis at March 1, 1913, for computation of income and losses. A refusal to recognize losses from March 1, 1913 values creates arbitrary discriminations among taxpayers whose actual net incomes for a given period are identical. The present ruling of the Court in effect makes the deductibility of a loss depend on whether the taxpayer "realized" the appreciation of his property shortly before March 1, 1913, by exchange or sale and reinvestment, thus making the tax depend upon adventitious circumstances rather than upon changes in economic condition.

11. The Flannery and Ludington decisions create inequality and injustice and tend to confusion and uncertainty in the determination of tax liability under the 1916 and 1918 Acts and even under the 1921 Act.

The Revenue Acts of 1916 and 1918 were in force for the five years beginning with 1916 and ending with 1920. The decision in the *Goodrich* case was rendered on March 28, 1921, and Treasury Decision 3206, reversing the previous uniform practice with respect to the ascertainment of loss from sale, was promulgated on July 8, 1921. Meanwhile all income tax returns for the five years in question had been prepared and filed, and to a considerable extent audited and approved, on the principle of allowing losses based on fair market value as of March 1, 1913, even where such value was higher than cost.

Following the promulgation of Treasury Decision 3206, the Bureau proceeded to review the unaudited returns under the 1916 and 1918 Acts upon the new theory, and attempted to impose additional taxes accordingly. As the practically unanimous opinion of the Bar, however, was that the decision in the *Goodrich* case, prescribing the ascertainment of gain upon the basis of March 1, 1913 value or cost, whichever was higher, did not limit taxpayers to an allowance of loss based on March 1, 1913 value or cost, whichever was lower, taxpayers generally opposed the redetermination of their tax liability in accordance with Treasury Decision 3206, and have by protest and appeal within the Bureau, or by claims for abatement and refund, held their cases open pending a final decision by this Court.

If, then, no relief be had from the rule in the *Flannery* and *Ludington* cases, many taxpayers, on whose returns the statute of limitations has run, will have paid taxes in accordance with the contemporaneous construction of the statute by the Treasury Department; while many other taxpayers, whose returns were audited after the promulgation of Treasury Decision 3206 on July 8, 1921, and who have appeals or claims pending, will be obliged to pay additional taxes on the basis of the changed construction of the statute; and still other taxpayers, whose returns were audited and apparently approved before July 8, 1921, but in whose favor the statute of limitations shall not yet have run, will be subjected to a reopening of their returns and to the payment of additional taxes in respect of matters which they had every reason to suppose were settled. On the other hand, the rule contended for by this petitioner would result in the adjustment of outstanding claims under the Acts of 1916 and 1918 in accordance with the basis employed in the audit of all returns previously reviewed and approved during the years in question and with the basis on which all returns for such years were actually prepared and filed.

As already indicated, the uniform allowance of losses from depreciation and depletion by the Treasury Department upon the basis of March 1, 1913 value, where such value was higher than cost, was authorized, not only under the 1916 and 1918 Acts, but also under the 1921 Act, by statutory provisions similar to the provision in Section 202 of the 1918 Act here involved, and in the case of depreciation under the 1916 and 1918 Acts merely by analogy to loss from sale. If no relief be had from the rule in the *Flannery* and *Ludington* cases, the Treasury Department may readily conceive that throughout the period of eight years beginning with 1916 and ending with 1923, during which the 1916, 1918 and 1921 Acts were in force, it has erred in its allowance of depreciation and depletion upon the basis of March 1, 1913 value, where such value was higher than cost, and may reopen all returns and redetermine all tax liability against which the statute of limitations shall not yet have run.

12. The Flannery and Ludington decisions are inconsistent with earlier holdings of this Court that any doubt in the words of a taxing statute should be resolved in favor of the taxpayer.

In *United States* v. *Merriam* (1923), 263 U. S. 179, the Court said at page 187:

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151, 153."

In the *Goodrich* case the Court resolved the doubt in favor of the taxpayer by establishing the basis of cost or March 1, 1913 value, **whichever is higher**. In the *Flannery* and *Ludington* decisions it has resolved the doubt in favor of the Government by establishing in the case of loss from sale the opposite basis of cost or March 1, 1913 value, **whichever is lower**.

Not only do the *Flannery* and *Ludington* decisions resolve doubts against the taxpayer, but in reversing the regulations these decisions in effect

> "impose an unexpected liability that if known might have induced those concerned to avoid it."
>
> *Lewellyn* v. *Frick*, No. 681, decided in this Court May 11, 1925.
>
> *Shwab* v. *Doyle* (1922), 258 U. S. 529.

We contend that in all computations of loss and gain under the 1918 Act the basis should be cost or March 1, 1913 value, whichever is higher. Such a uniform rule, now embodied in the 1924 Act, is consistent with the rule in the *Goodrich* case relating to gains, with the uniform practice of the Treasury Department relating to losses from depreciation, from depletion and (except for a brief period following the *Goodrich* decision) from casualty, and with an unforced and reasonable construction of the 1918 Act relating to loss from sale.

The rule for which we contend was adopted by Congress in the 1924 Act, which replaced the 1921 Act. This was done in accordance with Report No. 179 of the Committee on Ways and Means dated February 11, 1924, which said of this rule:

> **"It simplifies exceedingly the rule in effect under the present law without appreciable loss to the Treasury."**

WHEREFORE your petitioner respectfully prays that this cause be restored to the docket and that a rehearing

and reargument be ordered, and that such other and further relief be granted as may seem proper.

Dated, May 15, 1925.

Charles H. Ludington,
by
Hugh Satterlee,
William R. Perkins,
Ralph B. Evans,
Respondent's Attorneys.

I hereby certify that the foregoing petition is filed in good faith and not for the purpose of delay, and that in my opinion the relief therein prayed should be granted.

Hugh Satterlee,
Of Counsel.

SCHEDULE A.

Examples of Official Rulings under 1916 Act:

In *Regulations 33 (Revised)*, the last sentence of *Art. 116* (Paragraph 392) was as follows:

> "If a loss results from the sale of capital assets, the amount of the loss to be deducted will be ascertained in a like manner as if a gain had been realized, and will be the amount by which the selling price is less than the value, as of March 1, 1913, or less than the cost, if acquired subsequent to that date, as the case may be."

Regulations 33 (Revised), Art. 123 (Paragraph 411), was in part as follows:

> "* * * * the question as to whether profit or loss results from the sale will depend upon whether or not the value of the stock taken in payment for the assets is in excess of the fair market price or value as of March 1, 1913, of the assets sold or of their cost accordingly as they were acquired by the selling company prior or subsequent to that date."

Regulations 33 (Revised), Art. 157 (Paragraph 475), was in part as follows:

> "A corporation disposing of patents by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date."

Regulations 33 (Revised), Art. 168 (Paragraph 495), was as follows:

> "No deduction will be allowed for the depreciation of good will, trade-marks, and trade brands.

If such assets shall have been purchased at a determined price and shall be later sold at a price less than such cost, or less than their determined fair market value as of March 1, 1913, if acquired prior to that date, the amount by which the selling price is less than the cost or value, as the case may be, will be a loss deductible from the gross income of the year in which such assets were sold."

Treasury Decision 2740, approved June 24, 1918, was in part as follows:

"(b) In order to determine whether there has been gain or loss on a sale, and the amount of the gain, if any, in general under all three acts, an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property or the capital value that existed at the commencement of the period under consideration (either Jan. 1, 1909, or Mar. 1, 1913). . ."

In addition to its Regulations 33 (Revised), in January, 1918, more than a year before the enactment of the Revenue Act of 1918, the Treasury Department prepared for the convenience of taxpayers an "*Income Tax Primer*", which was issued as House of Representatives Document No. 841, Sixty-fifth Congress, Second Session. On the back of the front cover appeared the following notation:

"In the House of Representatives,
January 19, 1918.

ORDERED, that 38,910 copies of the Income Tax Primer, prepared by the Bureau of Internal Revenue for the information and assistance of taxpayers, be printed for the use of the House of Representatives and distributed through the folding room."

Questions 26 and 27, with their answers, appearing on page 9 of such Primer, are as follows:

"26. **How am I to determine what amount of gain or profit derived from a sale of property is returnable for income-tax purposes?**

If you acquired the property sold prior to March 1, 1913, you should take its fair market price or value as of that date, add thereto all amounts subsequently expended in making permanent improvements, then deduct the aggregate of all claims for depreciation in value of property claimed as deductions on previous returns, and the difference between the result thus obtained and the selling price is the amount to be reported under 'Gross income.'

If you purchased the property on or after March 1, 1913, the difference between its cost, plus all amounts subsequently expended for permanent improvements less depreciation previously claimed, and its selling price, is to be returned.

If the property came to you on or after March 1, 1913, as an inheritance, the difference between the appraised value placed upon it at that time plus all amounts subsequently expended for permanent improvements less depreciation previously claimed, and its selling price, is to be returned.

27. **How is the value as of March 1, 1913, of property sold determined?**

No method of determining this value can be stated which will adequately meet all circumstances. What that value was is a question of fact to be established by any evidence which will reasonably or adequately make it appear."

Question 82, with its answer, appearing on page 20 of such Primer, is as follows:

"82. **How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?**

The same method of computation should be followed as is outlined in the answer to the twenty-sixth question. If the result is a loss instead of a gain, that loss may be claimed as a deduction, if

it was connected with your regular business or trade, or during the same year you derived gains from other transactions entered into for profit but not connected with your regular business or trade in excess of the amount of your loss."

See also instructions on forms for tax returns for 1916 and 1917 at pp. 20-21 of Appendix to Brief for Respondent-Taxpayer.

Examples of Official Rulings under 1918 Act:

Regulations 45, Art. 141, until July 8, 1921, was in part as follows:

> "In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of."

Regulations 45, Art. 87, was in part as follows:

> "Property held by the taxpayer on March 1, 1913, is capital."

See also instructions on forms for tax returns for 1918, 1919 and 1920 at pp. 45-46 of Appendix to Brief for Respondent-Taxpayer.

Additional authorities on computation of losses:

As to depreciation and depletion:

Regulations 33 (Revised):
- Paragraph 488.
- Paragraphs 497-499 and 501.
- Paragraphs 504, 508.
- Paragraphs 538, 547.

Treasury Decision 2754, approved August 23, 1918.

Regulations 45, Articles 161 and 164.

See also:

Holmes Federal Taxes (Sixth Edition), p. 708.
Montgomery Income Tax Procedure (1924 Edition), note to p. 1006.
Commerce Clearing House Tax Service for 1923, Paragraph 71, note.
Standard Income Tax Service for 1923, Part One, Paragraph (747), p. 119.

SCHEDULE B.

In the *Appeal of Even Realty Company,* 1 B. T. A. 355, 356, 363 ff., decided by the United States Board of Tax Appeals on January 16, 1925 (after the argument in this case), the findings of fact were as follows:

> "The taxpayer, a Missouri corporation, had as its sole business the operation of an office building in St. Louis which it acquired, with the land upon which it stood, on June 4, 1909, at a total cost of \$41,942.36, and sold in 1920 for \$47,687.04. The evidence does not disclose the parts of the cost price attributable to land and building, respectively. On March 1, 1913, the property had a fair market value of \$35,000, of which \$11,800 was attributable to the land and \$23,200 to the building. The taxpayer on its books of account and in its returns under the Corporation Tax Act of 1909 and the Revenue Acts of 1913 and subsequent years, took no account of and claimed no deduction for depreciation, exhaustion, wear and tear or obsolescence of the building. In its income and profits tax return for 1920 the taxpayer reported as gain the difference between the cost of the land and building and the sale price thereof. On audit the Commissioner increased this gain by the equivalent of 2 per cent per annum on \$23,200 from March 1, 1913, to the date of sale, and determined a deficiency in tax accordingly in the sum of \$3,356.92."

The opinion of the Board was in part as follows:

> "This brings us to the question of the proper *basis* or starting point for the computation of the gain. The Revenue Act of 1918 provides that, in case of property acquired before March 1, 1913, the basis shall be the value on that date. But the Supreme Court has held in *Goodrich* v. *Edwards,* 255 U. S. 527, and *Walsh* v. *Brewster,* 255 U. S.

536, that if the cost were greater than the value on March 1, 1913, the taxpayer is entitled to use cost as a basis. These cases were decided upon a concession by the Solicitor General that the Constitution necessitated the conclusion reached, and though the Court did not say so in its opinions we feel that the conceded constitutional ground and not any rule of construction must have furnished the *ratio decidendi* of the Court's judgments. We are satisfied that Congress *intended* to make the March 1, 1913 value the basis for computing gain or loss. If the Constitution gives a taxpayer the right to recover the cost of his property, upon selling it, where that cost exceeds the March 1, 1913 value, before accounting for gain, it must follow that if he recovers the value of his property through deductions for exhaustion, wear and tear, and obsolescence, through writing of losses by casualty or theft, or otherwise, he must be entitled to the same capital recovery before accounting for profit thereon. It would be anomalous to say that the Constitution entitles a man to take out of his gross receipts from the *sale* of his property its cost to him, before reporting income, but that he is entitled to take out of his gross receipts from the consumption of the same property in producing his income, only a lesser sum (*c. f. Appeal of Grosvenor Atterbury,* 1 B. T. A. 169).

"The same considerations that lead us to the conclusion that adjustment for recoveries of capital by allowance for exhaustion, wear and tear, and obsolescence must be made in computing gain upon the sale of property, compel us to the belief that similar adjustments should be made to cost before comparing it with value on March 1, 1913, for the purpose of deciding which of them should be the *basis* for that computation. If the taxpayer recovered a part of the cost of his property before March 1, 1913, only the balance of that cost can properly be recoverable thereafter. The Constitution certainly does not entitle a taxpayer to recover any part of his cost more than once, before

becoming accountable for taxes upon his gain. If, after proper adjustment for partial recoveries, it appears that the cost exceeds the value at March 1, 1913, that adjusted cost rather than the March 1, 1913 value should be taken as the basis for all subsequent computations; if it be less than the March 1, 1913 value the latter is the proper basis. Thus, if a taxpayer in 1903 buys a building with a normal life of twenty years for $10,000, and recovers in rents one-half of that cost by 1913, he is entitled to recover thereafter through deductions or upon the sale of the property either $5,000 or the market value at March 1, 1913, whichever is higher. To allow more would be permitting him a double recovery of part of his capital investment before accounting for profit, and certainly the Constitution does not compel that."

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

SUPREME COURT OF THE UNITED STATES.

No. 733.—October Term, 1924.

Blakely D. McCaughn, Collector of Internal Revenue, Petitioner, *vs.* Charles H. Ludington.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 13, 1925.]

Mr. Justice Sanford delivered the opinion of the Court.

This case arises under the income tax provisions of the Revenue Act of 1918,[1] and presents another aspect of the question relating to deductible losses sustained from the sale of property acquired before March 1, 1913, which was involved in *United States* v. *Flannery*, No. 527, just decided.

Ludington bought, prior to March 1, 1913, certain corporate stock for $32,500. Its market value on March 1, 1913, was $37,050. He sold it in 1919 for $3,866.91, which was $28,633.09 less than its purchase price, and $33,183.09 less than its market value on March 1, 1913. In his income tax return he deducted the latter sum as the amount of his loss on the sale of the stock. The Commissioner of Internal Revenue reduced the amount of the deduction to the actual loss of $28,633.09, and assessed an additional tax against him. He paid this tax under protest, and, after the usual preliminary procedure, brought this suit against the Collector in a Federal District Court in Pennsylvania to recover the amount so paid. Judgment was entered for the defendant. 290 Fed. 604. This was reversed by the Court of Appeals. 1 Fed. (2d) 689. And this writ of certiorari was granted. 266 U. S. 599.

The case is governed by the decision in *United States* v. *Flannery*, *supra*. It was there held, on the authority of *Goodrich* v. *Edwards*, 255 U. S. 527, and *Walsh* v. *Brewster*, 255 U. S. 536, that the Act allowed a deduction to the extent only that an actual loss was sustained from the investment, as measured by the difference between the purchase and sale prices of the property. It follows

[1] Act of Feb. 24, 1919, c. 18, Title II, 40 Stat. 1057.

that as the actual loss to Ludington in the entire transaction was the difference between the purchase and selling prices, that is, $28,633.09, he was only entitled to deduct this amount, and not the difference of $33,183.09 between the market value on March 1, 1913 and the selling price. This is in exact correspondence with the decision in *Walsh* v. *Brewster, supra,* in reference to the second transaction there involved, in which it was held that the taxable gain derived from the sale of property was only the difference between the purchase and selling prices, and not the difference between the market value on March 1, 1913 and the selling price.

So under the Income Tax Law of New York which, as pointed out in *United States* v. *Flannery,* is a substantial transcript of the Revenue Act of 1918, except that January 1, 1919 is substituted for March 1, 1913, it was specifically held, in a case precisely similar to the present, that the loss deductible by the taxpayer was limited to the difference between the purchase and selling prices, although on January 1, 1919 the property had a higher value than when it was purchased, and the loss if computed from that date would have been greater than when computed from the purchase price. *People ex rel. Keim* v. *Wendell,* 200 App. Div. 388.

The judgment of the District Court is accordingly affirmed, and that of the Circuit Court of Appeals

Reversed.

Mr. Justice McReynolds and Mr. Justice Sutherland dissent.

A true copy.

Test:

Clerk, Supreme Court, U. S.